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CANADA

National Energy Board

Reasons for Decision

Westcoast Energy Inc.

RH-2-93



March 1994

Tolls

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National Energy Board**Reasons for Decision****In the Matter of****Westcoast Energy Inc.**

Application dated 14 July 1993, as amended,
for New Tolls effective 1 January 1994

RH-2-93**March 1994****Tolls**

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Services Canada 1994

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Recital and Appearances

IN THE MATTER OF the *National Energy Board Act* and the Regulations made thereunder; and

IN THE MATTER OF an application by Westcoast Energy Inc. for certain orders respecting its tolls pursuant to subsection 19(2) and Part IV of the *National Energy Board Act*; and

IN THE MATTER OF the National Energy Board Hearing Order RH-2-93.

HEARD in Vancouver, British Columbia on 18, 19, 20, 21, 22, 25, 26, 27 and 28 October 1993 and in Calgary, Alberta on 3 and 4 November 1993.

BEFORE:

R.L. Andrew Presiding Member

J.-G. Fredette Member

R. Illing Member

APPEARANCES:

J.W. Lutes Westcoast Energy Inc.
R.M. Sirett

H.R. Ward Canadian Association of Petroleum Producers
R.B. Wallace

A.R. Fraser Amoco Canada Petroleum Company Ltd.

S.M. Richards BC Gas Utility Ltd.
A. Fung

J.M. Pelrine British Columbia Petroleum Corporation

B. Rogers British Columbia Provincial Council of Carpenters

C.W. Sanderson CanWest Gas Supply Inc.

D. Bursey Council of Forest Industries of British Columbia,
R.B. Wallace Methanex Corporation and Cominco Ltd.

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G. Comfort	Eastern Natural Gas Management (B.C.) Ltd.
M.M. Mosely F.J. Weisberg	Export Users Group
H.N.E. Hobbs	Foothills Pipe Lines Ltd.
C.B. Woods	Mobil Oil Canada
N. Mills	NOVA Corporation of Alberta
S. R. Miller	Petro-Canada Inc.
F. Basham	Talisman Energy Inc.
A. Haskey	TransCanada PipeLines Limited
W.M. Moreland	Alberta Petroleum Marketing Commission
L.A. Boychuk	Board Counsel

Abbreviations

AFUDC	allowance for funds used during construction
APMC	Alberta Petroleum Marketing Commission
B.C.	British Columbia
BC Gas	BC Gas Utility Ltd.
CanWest	CanWest Gas Supply Inc.
CAPP	Canadian Association of Petroleum Producers
CAPP et al	CAPP, COFI and APMC
COFI	Council of Forest Industries of British Columbia, Methanex Corporation and Cominco Ltd.
DCF	discounted cash flow
EUG	Export Users Group
GPIS	gas plant in service
GPUAR	Gas Pipeline Uniform Accounting Regulations
GST	Goods and Services Tax
long-Canada	long-term Government of Canada bond
LPSF	liquid products stabilization and fractionation
NEB Act or the Act	National Energy Board Act
NEB or the Board	National Energy Board
O & M	operating and maintenance
Petro-Canada	Petro-Canada Inc.
PY	person year
TransCanada	TransCanada PipeLines Limited
Trans Mountain	Trans Mountain Pipe Line Company Ltd.
Westcoast, the Applicant or the Company	Westcoast Energy Inc.

Overview

(Note: This overview is provided for the convenience of the reader and does not constitute part of these Reasons for Decision. For details the reader is referred to the relevant sections of the Reasons for Decision.)

Tolls and Revenue Requirement for 1994

- The Board estimated that final tolls for a typical export service movement for 1994 will be approximately 4.5 percent lower than the 1993 tolls.
- The Board also estimated that the approved revenue requirement for 1994 will be approximately \$368 million, or approximately \$13 million less than the applied-for amount of \$381 million.

Rate Base

- The Board approved a rate base estimated at \$1,322 million for the test year, which includes the overruns reported by Westcoast.
- The Board directed Westcoast to remove from the applied-for GPIS costs of projects that have not been approved or have been denied under Part III of the *National Energy Board Act* as of 15 March 1994.
- Material and supplies inventory of approximately \$30 million was approved.
- The Board directed Westcoast to update its policy and procedures on inventory requirements and control.

Cash Working Capital

- The cash working capital allowance was reduced from the applied-for \$15.9 million to \$8.0 million to reflect a 38 day lag for payroll expenses, 15 day lag for other operating and maintenance expenses and an allowance of \$1 million for Goods and Services Tax.

Rate of Return

- The Board approved Westcoast's request to maintain its deemed common equity ratio at 35 percent. The Board also granted Westcoast a rate of return on common equity of 11.5 percent for the 1994 test year.
- The Board approved an unfunded debt rate of 7.44 percent for 1994 and denied a request from certain intervenors for an unfunded debt rate deferral account.

Operating Costs

- For 1994, the Board approved global O & M expenses of \$126 million, or \$1.1 million less than the applied-for amount of \$127.1 million.

- In relation thereto, the Board found reasonable the applied-for increases in person-years and overtime; opted for a uniform increase of 2.5 percent for salaries, wages and bonuses; and accepted a general inflation factor of 2.25 percent. Further, the Board was of the view that some proposed O & M items could have reflected more determination on the part of the Company to exercise cost restraint.

Toll Design and Tariff Matters

- The Board rescinded its direction as found in the RH-1-89 Reasons for Decision concerning the implementation of daily billing of interruptible volumes in Zones 3 and 4.
- The Board directed Westcoast to implement a renomination service by 31 October 1994 incorporating a provision that shippers contracting on Westcoast's system will have the right to accept or reject any renomination submitted to Westcoast.

Deferral Accounts

- With some exceptions, the Board approved the proposed disposition of the 1993 year-end balances of the existing deferral accounts, including the deferral of variances between the actual and forecast account balances.
- Regarding the 1993 year-end balance of the LPSF Service Revenue Variance deferral account, the Board approved Petro-Canada's proposal of crediting the forecast 1993 year-end balance to the 1994 cost of service related to the provision of LPSF Service.
- The Board approved for inclusion in the 1994 cost of service 75 percent of the balance in the utility/non-utility cost allocation study costs deferral account.
- The Board approved the capitalization, as part of the applicable capital projects, of the balances in the deferral accounts which recorded the demand charge credits paid by Westcoast in respect of shortfalls in deliveries of gas caused by construction of facilities in 1992 and 1993. For 1994, a deferral account is approved to record, without carrying charges, any demand charge credits paid by Westcoast in respect of curtailment of firm service caused by construction of facilities in 1994.

Chapter 1

Background and Application

By application dated 14 July 1993, Westcoast Energy Inc. ("Westcoast", "the Applicant" or "the Company") applied to the National Energy Board ("NEB" or "the Board") under subsection 19(2) and Part IV of the National Energy Board Act ("NEB Act" or "the Act") for an order or orders respecting interim and final tolls for 1994. On 28 July 1993, the Board issued Hearing Order RH-2-93 which set down Westcoast's application for hearing commencing 18 October 1993 and established the Directions on Procedure and the preliminary List of Issues.

On 10 September 1993, the Board issued Order AO-1-RH-2-93 in which the preliminary List of Issues was revised. Firstly, the Board accepted the request from the Council of Forest Industries of British Columbia, Methanex Corporation and Cominco Ltd. ("COFI") to modify and expand the issue which dealt with the continued appropriateness of Article 8 of the General Terms and Conditions, "Contract Demand Credits".

Secondly, as proposed by CanWest Gas Supply Inc. ("CanWest"), the Board decided to add to the List of Issues the question of whether demand charge credits are due to shippers for interruption in service as a result of planned maintenance carried out by Westcoast during 1993. CanWest proposed the addition of a second issue concerning the basis for calculating demand charge credits which resulted from the construction of new facilities by Westcoast in 1992. The Board noted that, by letter dated 7 September 1993, CanWest had filed an application under section 21 of the Act to review the Board's 6 May 1993 decision, wherein the Board accepted Westcoast's calculation of demand charge credits on the basis of the difference between nominated and authorized volumes. The Board stated that, in view of CanWest's application of 7 September 1993, it would consider CanWest's second proposal in conjunction with the Board's consideration of the section 21 application.

Thirdly, the Board acceded to the requests from Petro-Canada Inc. ("Petro-Canada") and BC Gas Utility Ltd. ("BC Gas") to add the issue of renomination to this proceeding. Petro-Canada also proposed to add the issue of increases in delivery pressures at various receipt points on the Fort St. John raw gas transmission pipelines. The Board noted that Westcoast had filed evidence on this subject and accordingly decided to add this issue to the List of Issues.

In its intervention, Petro-Canada also proposed to add the question of the toll design for the Liquid Products Stabilization and Fractionation ("LPSF") service. As well, Coast Pacific Management Inc. expressed a particular interest in the method of determining the tolls for Zone 4, Transportation Service - Southern. The Board noted, in its 10 September 1993 letter, that questions relating to tolls and general terms and conditions of existing service provided by Westcoast are within the ambit of toll proceedings, and, accordingly, took the view that it was not necessary to specifically identify these issues in the List of Issues.

On 30 September 1993, the Canadian Association of Petroleum Producers ("CAPP") filed a notice of motion for an order to delete from the List of Issues the issues concerning demand charge credits for 1994. As well, CAPP requested that the issue of who should bear the cost of demand charge credits be modified such that only credits paid prior to 1994 would be examined. CAPP proposed in its

direct evidence filed on 30 September 1993 that the issue relating to receipt point delivery pressure not be dealt with in this proceeding. On 7 October 1993, Westcoast filed supplemental evidence which, among other things, commented on CAPP's notice of motion and CAPP's proposal concerning receipt point delivery pressure. By letter dated 13 October 1993, the Board advised parties that it would consider CAPP's notice of motion and proposal as the first order of business at the hearing.

From 18 to 28 October 1993, the Board heard evidence in Vancouver, British Columbia and on 3 and 4 November 1993, heard argument in Calgary, Alberta.

On 20 October 1993, the Board rendered its decision on CanWest's 7 September 1993 application confirming its earlier decision which pertained to the basis of calculating demand charge credits. As well, the Board ruled on CAPP's notice of motion. Regarding CAPP's request to remove from the hearing all matters related to demand charge credits for 1994, the Board noted that, although parties who had spoken to the motion agreed with CAPP's objectives, there was no consensus on the manner in which these objectives could be achieved. The Board, therefore, denied CAPP's motion. Regarding the receipt point delivery pressure issue, the Board accepted CAPP's proposal, noting that parties who had expressed their opinion supported the proposal. The Board, however, declined to issue specific directions on how the matter should be dealt with outside this proceeding.

On 22 October 1993, Westcoast proposed to amend its application by leaving intact its existing provisions for demand charge credits except for a change that would commit Westcoast to offer shippers the alternatives of delivering gas from an alternate supply or of producing gas into line pack if capacity is available and operating conditions permit. No party objected to Westcoast's proposal and general support was given. Westcoast also proposed that the amendment would be in effect only for 1994, that the Board would agree to allow the continuation in 1994 of a deferral account regarding demand charge credits issued in respect of service curtailment caused by construction of facilities, and that service disruption, contract demand credits and related matters would be discussed further in a task force.

On 23 December 1993, the Board approved interim tolls for Westcoast and the Company's proposal to modify, as described above, its tariff provisions for demand charge credits.

Chapter 2

Revenue Requirement for 1994

A summary of the 1993 forecast, 1994 applied-for and 1994 approved (as estimated by the Board) test year revenue requirements is shown in Table 2-1. The 1994 applied-for revenue requirement represents an increase of 2.1 percent over the 1993 forecast. Having considered the evidence adduced in this proceeding, the Board has made adjustments to certain 1994 cost of service items. They are discussed in the following chapters. Based on these adjustments and subject to final determinations as indicated in Chapter 9, the Board has estimated that Westcoast's revenue requirement for 1994 would be \$368 million.

Table 2-1
1993 Forecast, 1994 Test Year Applied-for and Approved
Revenue Requirement

	(\$000)				
	1993 Forecast	Change	1994 Applied-for ¹	Board Adjustment	1994 Approved (Estimated)
Operating and Maintenance Expenses	123,172	3,913	127,085	(1,085)	126,000
Regulatory Costs	2,774	-	2,774	-	2,774
Depreciation	42,611	4,165	46,776	(700)	46,076
Amortization	(7,313)	7,493	180	-	180
Taxes Other Than Income Taxes	56,675	64	56,739	-	56,739
Miscellaneous Operating Revenue	(930)	(50)	(980)	-	(980)
Insurance Deductibles	853	58	911	-	911
Foreign Exchange on Debt	1,229	(164)	1,065	-	1,065
Gas Substitution Costs	450	-	450	-	450
Gas Used in Operations	109	(107)	2	-	2
Income Tax Expense	2,892	5,704	8,596	-	8,596
Return on Rate Base	131,794	17,943	149,737	(11,185)	138,552
Deferrals	18,612	(31,098)	(12,486)	(39)	(12,525)
Revenue Requirement	<u>372,928</u>	<u>7,921</u>	<u>380,849</u>	<u>(13,009)</u>	<u>367,840</u>

1 Application dated 14 July 1993, as amended

Note: Totals may not add due to rounding

Chapter 3

Rate Base

A summary of Westcoast's forecast rate base for 1993, and applied-for and approved (as estimated by the Board) rate bases for the 1994 test year is presented in Table 3-1. For computing the test year rate base, the Company used the 13-month average methodology previously approved by the Board. The Board has made adjustments to certain 1994 rate base items as discussed in this chapter. Based on these adjustments and subject to further filings by Westcoast as discussed in Chapter 9, the Board has estimated that Westcoast's rate base for 1994 would be \$1,322 million.

3.1 Gas Plant in Service

3.1.1 Capital Cost Overrun Report

In respect of plant additions to be included in 1994 rate base, Westcoast provided explanations on capital projects that had cost overruns in excess of \$50,000 or 10 percent of the estimated cost provided to the Board at the time Westcoast applied for these facilities.

Views of the Board

The Board finds reasonable Westcoast's explanations of 1993 capital cost overruns.

Decision

The Board approves the overruns reported in Westcoast's Capital Cost Overrun Report.

Table 3-1
1993 Forecast, 1994 Test Year Applied-for and Approved
Average Rate Base

(\$000)

	1993 Forecast	1994 Applied-for ²	Board Adjustment	1994 Approved (Estimated)
Gas Plant in Service	1,932,925	2,125,162	(35,800)	2,089,362
Accumulated Depreciation	<u>(679,066)</u>	<u>(720,627)</u>	<u>350</u>	<u>(720,277)</u>
Net Plant in Service	1,253,859	1,404,535	(35,450)	1,369,085
Net Plant in Service Adjustment	0	(16,229)	450	(15,779)
Contribution in Aid of Construction	<u>(4,236)</u>	<u>(4,056)</u>	<u>-</u>	<u>(4,056)</u>
Plant Investment	1,249,623	1,384,250	(35,000)	1,349,250
Materials and Supplies	28,004	29,953	-	29,953
Line Pack Gas	4,076	4,076	-	4,076
Prepaid Expenses	3,559	3,421	-	3,421
Deferrals	3,357	(6,243)	-	(6,243)
Deferred Income Taxes	<u>(70,068)</u>	<u>(66,406)</u>	<u>-</u>	<u>(66,406)</u>
Average Rate Base Exclusive of Cash Working Capital	1,218,551	1,349,051	(35,000)	1,314,051
Cash Working Capital	<u>11,373</u>	<u>15,914</u>	<u>(7,900)</u>	<u>8,014</u>
Average Rate Base ¹	<u><u>1,229,924</u></u>	<u><u>1,364,964</u></u>	<u><u>(42,900)</u></u>	<u><u>1,322,065</u></u>

1 Net of Alberta (Zone 5) Facilities

2 Application dated 14 July 1993, as amended in October 1993

Note: Totals may not add due to rounding

3.1.2 Plant Additions Transferred to Gas Plant in Service

In respect of plant additions during the test year, Westcoast provided a list of construction projects that it expects to complete in 1994. The Company also provided forecast amounts of completed plant costs that it expects to transfer each month to Gas Plant in Service ("GPIS"). As of the date of the application for 1994 tolls, some of the listed projects had not been approved by the Board under Part III of the Act and, in some instances, the application had not yet been filed.

Views of the Board

The Board is of the view that, for the purposes of determining plant additions to GPIS during the test year, it should use the most current information available. In the Board's opinion, only those projects which have been approved under Part III of the Act at the time the Board renders its decisions in this proceeding should be included in the test year rate base.

Decision

The Board directs Westcoast to remove from the applied-for GPIS the forecast amounts for projects which, as of 15 March 1994, have been denied or have not been approved by the Board under Part III of the NEB Act.

3.2 Materials and Supplies

Westcoast applied for materials and supplies of \$29.95 million for 1994, or an increase of 16 percent over the 1992 level of \$25.8 million. The yearly increases are of \$2.2 million in 1993 and \$2.0 million in 1994. Westcoast explained that, of the \$2.2 million increase for 1993, \$0.7 million were purchases of spare parts for Rolls Royce Spey engines used for compression purposes. Westcoast stated that it currently holds in inventory some \$3.2 million in Spey spare parts as well as an entire Spey unit valued at \$1.8 million. On the other hand, Westcoast indicated that its inventory policy was established in the 1950s and that it was unsure of the policy updates that were made since that time.

COFI was of the view that Westcoast's level of inventory is excessive. Further, it was concerned that the increase from 1992 to 1994 is substantially more than the inflation increase over the same period and that the causes for the increase have not been explained. It suggested that Westcoast should be directed to review and report to the Board its inventory practices and its requirements for emergency repair, operations and maintenance, and construction, and that Westcoast's 1994 inventory level should be reduced from \$30 million to \$27 million. Westcoast replied that its investment in GPIS increased by \$728 million over the period 1992 to 1994, or a 40 percent increase, which justifies the higher level of inventory of spare parts.

The Export Users Group ("EUG") was concerned that Westcoast continues to increase its inventory of spare parts for the Spey units although it is replacing some of these units by other types of engines. EUG suggested that a portion of the cost of Westcoast's inventory of these spare parts be disallowed. Westcoast replied that, due to the long delivery periods or unavailability of engine parts, it had to purchase additional spare parts to protect the integrity of new units as well as maintain existing spares.

Views of the Board

The Board recognizes that Westcoast's inventory increases from 1992 to 1994 are substantial. Nevertheless, in the light of the circumstances faced by Westcoast, the Board is of the view that these increases are reasonable. Regarding Westcoast's inventory of spare parts for Spey compressor units, the Board encourages Westcoast to consider the concerns expressed by interested parties and to adopt cost efficient practices in deciding the future level of that inventory.

As Westcoast indicated that it was unsure of the updates that were made to its inventory requirement and control policy, the Board is of the view that Westcoast should review and update this policy.

Decision

The Board accepts for inclusion in Rate Base Westcoast's 1994 forecast inventory level of \$29.95 million and \$0.7 million for 1993 purchases of spare parts for the Rolls Royce Spey engines.

The Board directs Westcoast to review its policy and procedures with respect to inventory requirements and control, and submit an updated copy to the Board.

3.3 Cash Working Capital

For the 1994 test year, Westcoast estimated a cash working capital allowance of \$17.9 million which it revised during the hearing to \$15.9 million to exclude insurance expenses and inventory issues, as required by the Board in the RH-1-89 Reasons for Decision. The Goods and Services Tax ("GST") portion of the allowance, estimated at \$3.4 million, is dealt with in sub-section 3.3.1.

In support of its estimate, Westcoast filed a lead/lag study based on actual data for 1992 which, it stated, was prepared in accordance with the principles used in the 1984 and 1990 lead/lag studies. Westcoast defined a revenue lag as the number of days from the end of the month in which transportation service is provided to the date revenues are received in the following month. Westcoast estimated a weighted average revenue lag of 27 days. In respect of expenses, Westcoast defined a disbursement lag as the number of days from the date a cheque is written to the end of the month. It computed weighted average disbursement lags for each category of expenses and each month in 1992 using the amounts and the dates of payments. Westcoast claimed a cash working capital allowance based on net lag days equal to the disbursement lag, plus the revenue lag of 27 days, minus, only for expenses other than salaries and wages, a cheque cashing lag of seven days. The cheque cashing lag represents the average number of days between the dates cheques are written and the dates they are cashed.

In support of its methodology, Westcoast stated that, for accounting purposes, it records expenses on a cash basis, that is, when a cheque is written in payment rather than on receipt of goods and services or on receipt of an invoice therefor. It also contended that, for expenses recorded in a month, which it called a cost-of-service month, it gets reimbursed on the 27th day of the following month.

With respect to salaries and wages, Westcoast claimed a cash working capital allowance of \$8.2 million, based on 55 lag days at the daily amount of payroll cost forecast for the 1994 test year. Excluding the revenue lag of 27 days, the Board notes an average disbursement lag of 28 days. Further, the lead/lag study shows that monthly disbursement lags in 1992 varied from 21 to 31 days. In respect of disbursement of payroll, Westcoast stated that employees are paid on alternate Fridays; in addition, the evidence indicates that not all employees are paid on the same Friday. For each week in 1994, Westcoast identified the date of pay cheques, the related pay period and the accounting month in which the expense would be recorded. For instance, the Board notes that the cheques to be dated 21 October 1994 would relate to the pay period ending 23 October and would be recorded as a November expense. This evidence indicates that, under Westcoast's study methodology, salaries and wages for days worked in a month may not necessarily be recorded as an expense for that month.

With respect to other operating expenses such as outside purchases, outside services and other operating expenses, Westcoast calculated a net lag of 34 days which reflected an average disbursement lag of 14 days, plus the revenue lag of 27 days, minus the cheque cashing lag of seven days. Westcoast acknowledged that it takes advantage of the payment terms offered by suppliers, which are, on average, net 30 days. Westcoast maintained, however, that its methodology is based on the dates of payments to suppliers and the date of revenue receipts from its shippers, and that the dates on which services are provided to Westcoast, or the dates of the invoices therefor, are not relevant to the cash working capital calculation.

According to CAPP, tolls for transportation service rendered in a given month, say July, which in this case Westcoast would collect on 27 August, should relate to goods and services provided to Westcoast during July. CAPP contended that Westcoast would not require a cash working capital allowance for the goods and services received in July if suppliers' invoices allowed Westcoast to pay after 27 August. CAPP argued that lag days for cash working capital requirement should reflect the dates when services are provided and should not be based on the dates when Westcoast writes cheques to pay invoices. CAPP argued that Westcoast's cash working capital should be based on the service concept referred to in RH-2-92 Reasons for Decision in respect of TransCanada PipeLines Limited ("TransCanada"). In that decision the Board indicated that in a conventional lead/lag study the company would be required to take into account the length of time between the date it receives goods and services and the date it makes the corresponding payments for them.

COFI disagreed with Westcoast's method of recording costs because the method does not recognize suppliers' payment terms or the month and date when the goods and services are actually received. Further, COFI noted that, notwithstanding its cash basis of recording expenses, Westcoast switches back to the accrual system in December to catch up and to ensure that the recorded year-end results are correct. COFI argued that Westcoast's methodology is an "artificial construct" that benefits the Company by substantially overstating its cash working capital requirement. CAPP and COFI contended that the number of lag days calculated by Westcoast is overstated and proposed reductions of 30 lag days for each of payroll and other operating expenses, which they estimated would translate into reductions in working capital of \$4.4 million and \$4.7 million, respectively.

Views of the Board

Salaries and Wages

The Board notes that for salaries and wages a disbursement lag of 28 days, which is the weighted average number of days from the date of the pay cheques to the end of the month, is equivalent to Westcoast paying its employees a whole month's salary in advance, on the second or third day of each month. In this regard, the Board considers the disbursement lags calculated by the Company, such as 31 days for November 1992, to be unreasonable. The Board finds the Company's cash working capital requirement based on the filed lead/lag study unacceptable.

The Board, however, does not accept CAPP's and COFI's contention that the number of lag days is overstated by 30 days and that the applied-for cash working capital should be reduced by \$4.4 million. CAPP and COFI did not file data in support of their position. Nevertheless, the Board observes that usually only the first pay cheques in a month would include salaries and wages for days worked in the preceding month. The Board is of the view that, while Westcoast's methodology would result in an exaggerated number of lag days, the annual average overstatement would not amount to 30 days.

To set final tolls for 1994 in this proceeding, the Board finds it necessary to determine a reasonable allowance for cash working capital based on information filed in this proceeding.

The Board has analyzed the cash outflows of payroll costs and cash inflows of corresponding revenues. In respect of the timing and the amount of cash outflows, the Board considered that in 1994 pay cheques issued on each Friday would be in the amount of the weekly average payroll cost for the year. With respect to cash inflows the Board considered that, on the 27th day of each month, Westcoast would collect revenues which cover one-twelfth of the annual salaries and wages. The Board considered this approach reasonable in the light of the manner in which Westcoast's tolls are set and revenues are collected. Westcoast's tolls are largely derived from an estimated annual revenue requirement which is classified fixed for toll design purposes. Therefore, the toll revenues which Westcoast collects each month for the transportation service provided in the preceding month are essentially fixed at approximately one-twelfth of the revenue requirement determined for the test year.

Since Westcoast's tolls are designed for a test year commencing on 1 January, Westcoast would collect the first revenues, for the transportation service provided in January 1994, on 27 February 1994 and the last revenues, for the transportation service provided in December 1994, on 27 January 1995. At that point in time, Westcoast is deemed to have collected its approved payroll costs for the test year. By reference to 27 January 1995, the Board calculated the number of lag days and lag dollar-days for the whole year for the expense and revenue streams. The Board then determined the outstanding dollar-days for the year, which it considered to be a measure of the amount and time investor-supplied funds would be required to meet ongoing payroll expenses. The cash working capital allowance is the amount of dollars to be included

in rate base that would compensate Westcoast's investors for financing the outstanding dollar-days. In terms of lag days, the Board's calculation yields a lag of 38 days.

The Board is of the view that, for the 1994 test year, a cash working capital allowance for salary and wage expense based on 38 lag days would be reasonable. The Board estimates that this will result in a reduction of \$2.5 million in the applied-for cash working capital allowance.

Other Operating and Maintenance Expenses

The Board notes that, notwithstanding Westcoast's contention that it records expenses on a cash basis, the Company conceded that it accrues virtually all significant invoices at year end. This being the case, the Board believes that Westcoast's total expenses in a given year would approximate to the same total had Westcoast used an accrual based accounting system throughout the year. Therefore, the Board considers it appropriate to test the reasonableness of Westcoast's estimate of its cash working capital requirement in the light of an accrual based system.

Under an accrual system, expenses would be recorded upon receipt of invoices, which would normally be prior to the month in which the expenses are being paid, assuming a 30 day payment term. In that case, Westcoast would consider the revenues to be collected in the same month in which expenses are paid. Thus, Westcoast would calculate a lower number of lag days than it now calculates under its cash based system. A related factor which the Board considers may cause overstatement of the number of lag days is the fact that Westcoast closes its accounts payable on the 24th day of a month and records cheques processed after that date as payments at the beginning of the following month. Thus, the Company counts lag days from the beginning of the following month to the next revenue receipt day.

The Board notes that Westcoast's lead/lag methodology results in the same number of lag days, and, therefore, the same allowance for cash working capital, whether the Company pays all its invoices in cash upon receipt, or pays some 30 or 60 days later in accordance with the payment terms offered by suppliers. It appears to the Board that this is a consequence of Westcoast's assumption that, for all cheques issued in a month, regardless of the payment terms on invoices, it gets reimbursed only in the following month. The Board, however, notes that Westcoast collects the same amount in toll revenues from shippers, whether its operating and maintenance expenses vary from month to month or whether they are recorded on an accrual basis or on the cash basis followed by the Company.

While the Board finds that Westcoast's methodology overestimates the number of lag days, it considers the overstatement of 30 days estimated by CAPP and COFI and the proposed \$4.7 million adjustment to cash working capital allowance to be excessive. Based on an analysis of information filed by Westcoast, in order to set final tolls for 1994, the Board has determined the number of lag days which the Board believes to be reasonable for calculating an allowance for cash working capital for 1994.

The Board has analyzed the cash outflows and cash inflows in respect of outside purchases, outside services, and other operating expenses using the 1992 data provided in the lead/lag study. For cash outflows, the Board used the amount and disbursement lag provided for each month in 1992. For cash inflows, the Board considered one-twelfth of the annual amount of each expense category as being covered by the revenue collected on the 27th day of each month. The Board notes that, upon collection of the revenues on the 27th of January following a test year, Westcoast is deemed to have collected its total operating expenses reflected in the test year revenue requirement. The Board is of the view that this date provides a logical reference point to measure the number of lead/lag days for both expenses and revenues streams.

The Board estimated the number of lag days and lag dollar-days for both cash outflows and cash inflows for the 12 month period and then estimated the net outstanding dollar-days and the net number of lag days. The Board's calculation yielded a lag of 17 days. With respect to cheque cashing lag, the Board has decided to allow an adjustment of two days for the 1994 test year.

Accordingly, the Board is of the view that, for the 1994 test year, Westcoast's cash working capital allowance for outside purchases and outside services and other operating expenses should be based on 15 lag days. The Board estimates that this will result in a reduction in the applied-for cash working capital allowance of \$3.0 million.

Decision

The Board finds that for the 1994 test year Westcoast's cash working capital allowance should be calculated using 38 days lag for payroll expenses and 15 days lag for outside purchases, outside services and other operating expenses. The Board estimates that, excluding the GST component, its decision would result in a reduction in cash working capital allowance of approximately \$5.5 million from the applied-for level.

3.3.1 Goods and Services Tax

In its 1994 rate base, Westcoast included a working capital allowance of \$3.4 million for GST.

Effective 1 January 1991, Westcoast pays GST at the rate of seven percent to suppliers of goods and services in respect of operating and maintenance expenses (excluding payroll) and construction of plant. Westcoast also collects GST at the rate of seven percent from shippers on the toll revenues. There is a time lag but Westcoast is able to offset the amount that it pays to suppliers against the amount that it receives from shippers. For each reporting month Westcoast files a GST return with Revenue Canada at the end of the following month at which time Westcoast may be in a pay or refund situation.

For 1994, Westcoast estimated that its GST payments (i.e. GST credit) to suppliers would total \$31.3 million, which includes \$4.2 million for operating and maintenance and \$26.9 million for plant construction, while its collections would be \$27.7 million. The associated shortfall in the GST account would be of \$3.6 million for the year. However, Westcoast would be fully reimbursed for the

shortfall by refunds claimed on its GST returns filed with Revenue Canada. Westcoast counted 36 lag days between payment of GST to suppliers and receipt of revenues, and 34 lead days between receipts of revenues and payments of GST to Revenue Canada. Westcoast then calculated a lag period of 45 days for which it claimed, at the average daily amount of the annual GST collection, a cash working capital allowance of \$3.4 million.

COFI recommended that the GST component of the cash working capital allowance estimated for the test year be reduced by \$2.9 million, which is the amount of increase from the previous year. COFI noted that Westcoast did not explain or substantiate the need for the increase.

Views of the Board

The Board notes that Westcoast's GST collection is approximately six times its GST payment on operating and maintenance expenses and, as such, in normal years, GST may be a source of working capital and should reduce its rate base allowance for cash working capital. However, during periods of large construction projects, such as in 1994, the Company would pay out more GST than it would collect from shippers, and, given the time lag between payment to suppliers, collection from shippers and refund from Revenue Canada, a cash working capital allowance on account of GST would be required. However, given the level of cash outflows and inflows on this account and the respective lead/lag days, the Board does not accept Westcoast's calculation that its cash working capital requirement in respect of the GST for the 1994 test year should be \$3.4 million.

The Board notes that, since GST came into effect on 1 January 1991, Westcoast made its first GST collection in February 1991, when it received the toll revenues for the transportation service provided in January 1991. As well it made its first GST payment in February 1991 when it paid suppliers' invoices for goods and services received in January, assuming that it took advantage of the 30 day payment term. Following this sequence to the 1994 test year, it appears to the Board that a lead/lag analysis in respect of GST should consider that, in relation to any given month, GST payments on goods and services and GST collections on tolls occur in the immediately following month.

The Board notes that for each reporting month a return is to be filed on the last day of the following month ("GST return day"). On the return filed for each reporting month, GST collected must equate to the sum of the amount paid to suppliers and the amount paid to or claimed as refund from Revenue Canada. The Board considers that the GST return day provides a logical reference point to measure the lead/lag days for GST inflows and GST outflows. The Board is of the view that the outstanding dollar-days for each reporting month may be calculated as follows: (a) the GST outflow in the reporting month multiplied by the number of days from the payment day to the GST return day; minus (b) the GST inflow in the reporting month multiplied by the number of days from the collection day to the GST return day. The Board considers that the aggregate of the outstanding dollar days for the 12 month period, divided by 365, yields a reasonable cash working capital allowance to be included in or deducted from the test year rate base.

Accordingly, using Westcoast's forecast of total GST payments and collections in 1994, the Board estimates that a cash working capital allowance for GST of \$1.0 million would be reasonable. In this estimate the Board has considered it reasonable to provide for one month's delay by Revenue Canada in making refunds.

Decision

For the 1994 test year, the Board allows a cash working capital allowance of \$1 million for the GST.

Chapter 4

Capital Structure and Cost of Capital

Westcoast applied for a rate of return on average common equity of 12.50 percent for the 1994 test year, based on a deemed common equity component of 35 percent. Details of the applied-for capital structure and requested rates of return are shown in Table 4-1.

Table 4-1

**Applied-For Deemed Average Capital Structure
and Rates of Return for the 1994 Test Year**

	<u>Amount</u> (\$000)	<u>Capital</u> <u>Structure</u> (%)	<u>Cost</u> <u>Rate</u> (%)	<u>Cost</u> <u>Component</u> (%)
Debt - Funded	857,638	54.60	10.29	5.62
- Unfunded	<u>128,568</u>	<u>8.18</u>	8.65	<u>0.71</u>
Total Debt Capital	986,206	62.78		6.33
Preferred Share Capital	34,881	2.22	7.94	0.18
Common Equity	<u>549,816</u>	<u>35.00</u>	12.50	<u>4.37</u>
Total Capitalization	<u>1,570,903</u>	<u>100.00</u>		
Rate of Return on Rate Base				<u>10.88</u>

4.1 Common Equity Ratio

Westcoast applied to maintain its deemed common equity ratio at the currently approved level of 35 percent. Westcoast requested no change to its common equity ratio even though it claimed that its business risks are trending upward mostly due to rising competition in the Pacific Northwest markets. Westcoast suggested that changes to a common equity ratio should occur only when there are significant changes in fundamental economics or when warranted by financial constraints.

CAPP, the Alberta Petroleum Marketing Commission ("APMC") and COFI ("CAPP et al") jointly sponsored witnesses to address Westcoast's cost of capital matters. Mr. Nettleton addressed the business risks of Westcoast and Dr. Waters covered rate of return on common equity and capital structure. CAPP et al recommended a ratio of between 25 and 28 percent.

In arriving at their recommendation, CAPP et al explained that they took into consideration their findings that the utility operations of Westcoast are subject to minimal business risks and have

minimal need for financing flexibility; that the consolidated interest coverages of Westcoast Energy Inc. are very low; and that there is a demonstrated acceptance by investors of the consolidated entity's present capital structure.

EUG requested a common equity of 30 percent to accord with the level prescribed for TransCanada, NOVA Corporation of Alberta and other pipelines. In argument, APMC refined its position and recommended 26.5 percent, which is the mid-point of the 25 to 28 percent range included in CAPP et al's evidence.

Market Risk

Westcoast argued that the two most significant demand risks associated with domestic volumes are the British Columbia ("B.C.") economy's dependence on cyclical resource industries and the desire of BC Gas to diversify its supply sources. Regarding its export market, Westcoast claimed that the Pacific Northwest market is also cyclical because of the dependence on the forest products industry. It also claimed that the exports are market sensitive because (1) deliveries are made either to industrials and electric utilities or to service customers, (2) customers are able to access gas supplies through the pipeline system of Northwest Pipeline Corporation and Pacific Gas Transmission Company, and (3) industrial users can use alternative fuels, particularly fuel oil.

According to Westcoast, market risks in the export markets are also affected by the short-term nature of transportation contracts. It also noted that approximately 70 percent of its service contracts terminate by October 1996 and that there is substantial market risk related to short-term exports to the Pacific Northwest because the underlying gas sales are similarly short-term in nature.

Westcoast stated that, since the last Board decision, the most significant change in its demand risk arose from increasing uncertainty in the California markets and the proposed additional pipeline capacity into the Pacific Northwest, particularly expansions of Pacific Gas Transmission Company's pipeline. Westcoast explained that a 1993 expansion was intended to provide for the transportation of significant volumes to California and the Pacific Northwest, but that only 40 percent of the incremental capacity in California has been contracted for by end-users. Westcoast claimed that, as a result, the unutilized capacity may be used to increase deliveries to the Pacific Northwest market, creating intense gas on gas competition.

Westcoast submitted that the Board should give no weight to Mr. Nettleton's evidence. Westcoast stated that many of the points that he raised to suggest lower business risks for Westcoast, such as the Free Trade Agreement and the unbundling of the Westcoast system, have been factored into assessments of Westcoast's business risks since 1989.

CAPP et al argued that Westcoast has been able to earn almost exactly its allowed return in recent years and that Westcoast has a very optimistic view of its growth in throughput over the next four years, as expressed in its reports to shareholders, in a recent speech made by its President, and in the recent application for expansion of the Pine River processing plant.

CAPP et al claimed that the longer term risk of Westcoast is low because of a number of factors, including substantive reserve additions, increased deliverability and growing demand in the export market. It also claimed that pipeline construction on the Northwest Pipeline Corporation system has expanded the economic reach of B.C. gas and that access to exports will likely be further improved

with full implementation of FERC Order No. 636 in 1994 by which time Westcoast's shippers should be able to utilize released U.S. transportation capacity to satisfy the requirements of U.S. buyers.

CAPP et al also stated that all pipelines regulated by the Board are subject to lesser business risk now than in the past because of a better functioning market for natural gas brought about by deregulation and the associated open access transportation, and market-based pricing initiatives in both Canada and United States.

CAPP et al argued that the business risks raised by Westcoast are exaggerated and contradict the optimistic outlook otherwise conveyed by the Company. They also argued that market risk is firstly a risk to the producers, secondly to the remaining users on the Westcoast system and only remotely to Westcoast. Also, while it conceded that resource industries are cyclical, it also pointed out that, in their view, the toll methodology adopted by the Board gives Westcoast a high degree of assurance that fixed costs will be recovered regardless of the level of throughput. CAPP et al's view was supported by EUG who stated that, to the extent that competition in the Pacific Northwest exists, Westcoast is effectively immunized from any associated risk by reason of the toll setting mechanisms that the Board uses for Westcoast.

Operating Risks

Westcoast claimed that the main operating risks that it faces arise from the high proportion of utility plant in raw gas transmission and processing and the decreased operating flexibility on its system. Westcoast elaborated that, currently, more than half of its rate base is in raw gas transmission and processing plants and that the proportion will further increase when the Pine River plant is completed in 1994. Westcoast claimed that these facilities are inherently subject to greater operating risks than large diameter pipelines and stated that most of the gas that it processes is sour gas which, it claimed, has a greater corrosive effect on the pipe.

It also stated that the processing plants are subject to bypass risks inasmuch as it estimated that approximately 15 percent of the gas produced in British Columbia does not use Westcoast's gas processing facilities, and raised the point that the mountainous terrain traversed by Westcoast's mainline creates relatively high physical risks.

CAPP et al accepted that Westcoast's plant and operations are exposed to a greater multitude of physical hardships than those of other pipelines, but did not agree that these circumstances have a significant bearing on the risks borne by Westcoast's shareholders. It argued that Westcoast's facilities are engineered with these conditions in mind and that its personnel is now very experienced, which reduces the risks to which the facilities are exposed.

It also submitted that, when confronted with plant outages and shutdowns, Westcoast would either defer other maintenance items and repair the problem as part of its regular maintenance expense or, if the item is too large or falls into another cost category, will seek a deferral account or approval of a separate facilities application under section 58 of the Act.

Comparative Business Risks

Westcoast believes that its business risks are greater than those of TransCanada for two basic reasons: (1) TransCanada serves more diverse markets across Canada and in the Midwestern and Eastern United States, and ships a lower portion of its total throughput to export markets; and (2) Westcoast is exposed to higher operating risks than TransCanada. Westcoast indicated that it has 53 percent of its

net utility plant invested in raw gas transmission and processing facilities, which it claimed are inherently of greater operating risk than mainline transmission pipe, and noted that TransCanada has no processing facilities.

CAPP et al believe that Westcoast's short-term business risks are now approximately the same as TransCanada's because the longer term risks faced by both pipelines are low due to such factors as prospects for substantive reserve additions, increased deliverability and growing demand in the export market.

While they acknowledged that Westcoast has a more operationally complex system than TransCanada because of the additional processing and gathering functions, CAPP et al also stated that both pipelines are dependent upon extensive trunk line systems combined with gas processing plants that remove sulphur, liquids and other components. CAPP et al also indicated that, in their opinion, from a business point of view, Westcoast is in a preferable position because it has complete control of contracts, investments, operation and maintenance from the well head to the points of delivery for both the domestic and export markets. Westcoast countered the latter argument by stating that, in the context of regulation, the concept of control of facilities, on which the owners' return is limited, has little, if any, significance.

EUG was of the view that Westcoast's capital structure should not only be compared to TransCanada's. They stated that, at its current level of 35 percent, the Company's capital structure is anomalous when compared to that of other pipelines, including Interprovincial Pipe Line Inc., Trans Mountain Pipe Line Company Ltd. ("Trans Mountain"), NOVA Corporation of Alberta and Alberta Natural Gas Company Ltd, whose common equity ratios have all been recently reduced by their regulators. EUG noted that there appears to be a consensus by regulators that the business of transmission pipelines is simply not that risky.

Balance Between Debt and Equity Elements of Deemed Capitalization

Westcoast submitted that the Board should find its proposed capital structure for 1994 acceptable because it is essentially unchanged from that approved by the Board in the RH-3-92 Reasons for Decision. Further, Westcoast suggests that the Board should consider the interest coverages which result from the applied-for capital structure and rate of return on equity, noting that the result is an interest coverage ratio of 1.81 which, it submits, is consistent with an A bond rating.

Westcoast was of the view that the adoption of CAPP et al's recommended capital structure, which Westcoast estimated would yield an interest coverage ratio of 1.51, would result in a downgrading of Westcoast's bonds.

In addition, Westcoast compared its utility capital structure with those approved for 29 major Canadian utilities, and found that its debt ratio lies in the top quartile and that a 35 percent deemed equity ratio lies below the median 38 percent approved ratio.

CAPP et al contended that the interest coverage ratios that would result from its recommended capital structure would not restrict Westcoast's ability to raise funds on acceptable terms as evidenced by Westcoast's ability to raise substantial amounts of capital at favourable yields relative to Government of Canada issues of the same term.

Balance between Deemed Utility Equity and Actual Non Utility Equity

Westcoast indicated that, while the financing of its rate base had remained virtually unchanged since RH-3-92, the financing of its other investments had become significantly less leveraged. Westcoast explained that, while its acquisition of Union Energy Inc. for \$618 million was initially financed by a mix of equity and debt, the debt was fully repaid through the sale of Westcoast Petroleum Ltd. and a new equity issue. The effect of these transactions, Westcoast explained, was that its debt financing of Westcoast's other investments decreased from 32 to 22 percent on a non-consolidated basis, using the equity method of accounting, since the last proceeding, which should remove, in its view, any concern of cross-subsidization.

Consistent with its submission in prior proceedings, Westcoast submitted that concerns of cross-subsidization of its non-utility operations by its utility operations, except for its investment in Westcoast Gas Inc., is more appropriately evaluated in the context of unconsolidated corporate balance sheets, which use the equity basis of accounting for investments, rather than consolidated corporate balance sheets. Westcoast explained that the equity approach better reflects the fact that some debt held by Westcoast's subsidiaries is non-recourse to Westcoast. Regarding Westcoast Gas, the holding company of Centra Gas Inc., Westcoast explained that its investment was originally financed with 75 percent debt and 25 percent equity and that, by the end of 1994, it expects its equity ratio to be 44 percent. Westcoast highlighted that, in its opinion, reliance on consolidated financial statements is fundamentally inconsistent with the utility stand-alone principle.

In summary, Westcoast submitted that its equity ratio in Westcoast Gas is quite adequate and that its other investments, 90 percent of which are in utilities and that are leveraged at less than the 30 percent level, should not raise cross-subsidization concerns.

Regarding whether Westcoast's debt cost had been adversely affected by its non-utility operations, Westcoast submitted that no evidence was provided to suggest that the financing of non-jurisdictional activities had an adverse impact on its debt cost.

CAPP et al stated that the actual consolidated common equity ratio, combined with the corporate structure of Westcoast, provides an indication of the amount of equity needed in Westcoast utility's capital structure. It was suggested that, if one accepts that Westcoast should have actual equity sufficient to match the deemed equity amounts granted by its various regulators, the entity Westcoast Energy Inc. will have a shortfall of equity of \$475 million at year-end 1994. They indicated that this was a conservative estimate since it assumes that no equity is required for Westcoast's non-regulated businesses. CAPP et al's view was supported by the APMC who stated that Westcoast does not have enough equity in its consolidated capital structure to support the 35 percent deemed common equity component currently allowed by the Board. The APMC indicated that Westcoast is earning a return on equity that is not actually provided or available to it.

CAPP et al suggested that, because some 90 percent of Westcoast's activities are now in the utility area, the Board has an opportunity to observe the reactions of investors to Westcoast as essentially a utility. They also argued that the various subsidiaries are of approximately equal risk and that a common equity ratio lower than 35 percent would be acceptable given that investors are willing to pay handsomely for the opportunity to invest in a company which has only 22 percent common equity associated with those assets.

CAPP et al suggested that according to a number of sources, including "Advanced Corporate Financial Reporting: A Canadian Perspective", the equity method of accounting is not regarded as a valid substitute for consolidation. Thus, for subsidiaries, CAPP et al concluded that the detail disclosed by consolidation is indeed important. They noted that the Canadian Bond Rating Service used consolidated financial statements to assess the financial status of Westcoast and that the British Columbia Utilities Commission relied on them as well to determine the appropriate capital structure for BC Gas.

CAPP et al claimed that, since the market price of Westcoast Energy's stock reflects anticipated future returns, a market-to-book ratio of one would indicate sufficient return on equity invested. In their opinion, the fact that the market-to-book ratio is 1.4 indicates that investors are expecting Westcoast's common equity rates of return to exceed their required rates of return in future years. Westcoast argued that market-to-book ratios can reflect a multitude of factors, including movement of the market as a whole, changes in interest rates, and changes in investor expectations.

Views of Messrs. Andrew and Fredette

In determining the appropriate capital structure for Westcoast, the Board is guided by: (1) the business risks faced by the Company's utility operations; (2) the maintenance of an appropriate balance between the debt and equity elements of the deemed capital structure; and (3) the determination that sufficient actual equity is left to underpin the Company's non-utility activities, having regard to the equity financing attributed to the utility through the deeming process.

The deemed common equity ratio of Westcoast is set to reflect the inherent business risks to which the utility is exposed, including long-term risks. In the Board's view, changes in business risks from one year to the next would have to be significant and represent a change of a long-term nature before an alteration of the common equity ratio would be warranted. The Board first set the deemed common equity ratio for Westcoast at 35 percent in November 1980. Although the Company has been exposed to changes in markets, supply and operations and has had its equity ratio reviewed at six different toll hearings, the deemed common equity ratio has remained unchanged.

In reaching its conclusions on capital structure in this instance, the Board has taken into consideration, among other things, Westcoast's continuing positive market outlook on the one hand and the possibility of increased risks in the Pacific Northwest market from past and possible future Pacific Gas Transmission Company expansions on the other. The Pine River plant expansion will raise only slightly the share of Westcoast's assets in gathering and processing and will be offset by continued main gas transmission line expansion. In summary, the business risks faced by Westcoast have not changed significantly since the last hearing. More importantly, having regard to the history of business risks faced by Westcoast since 1980, the Board is of the view that any change that has occurred falls within a range that is consistent with a deemed 35 percent common equity component in Westcoast's capital structure.

As in the past, the Board notes that there are differences between TransCanada's pipeline system and Westcoast's. For instance, Westcoast includes a gathering system and gas processing plants, whereas TransCanada does not. Further, TransCanada

serves diverse markets both in Canada and in the United States, whereas Westcoast's market outlets are somewhat more restricted. There are differences in the supply basin to which each pipeline is connected. The Board is of the view that, taken in their entirety, these differences indicate that Westcoast faces higher total business risks than TransCanada. However, the Board also recognizes that any assessment of such differences is to a large extent judgemental in nature, and places only limited weight on this comparison in arriving at its decision regarding the appropriate deemed common equity ratio.

As for the question of an appropriate balance between the debt and common equity elements of the utility's capital structure, the Board notes that Westcoast's preferred capital represents approximately two percent of its capital structure. As well, the Board considers Westcoast's debt ratio to be consistent with the risks to which the Company is exposed. Seen in this context, the Board considers that 35 percent continues to be a reasonable figure for the deemed common equity component.

Turning to the possible cross-subsidization of Westcoast's non-utility activities by the utility, the Board acknowledges the efforts of intervenors in rigorously pursuing this issue, in particular, from the perspective of whether there is sufficient actual equity left to underpin the Company's non-NEB regulated activities, having regard to the common equity attributed to the utility through the deeming process. The Board is cognizant of the fact that Westcoast's consolidated common equity ratio of approximately 23 percent in 1994 is significantly lower than the deemed common equity ratio prescribed by the Board. The Board has considered the factors which have an impact on the Company's consolidated common equity. These include the double leverage of the holding company, i.e. the financing of Westcoast's investments in the common equity of subsidiary companies partly with debt, and the losses from discontinued operations. Taking these factors together, the Board is not persuaded at this time that cross-subsidization has occurred.

At this time, the Board's main concerns with respect to Westcoast's investments in non-utility activities and the issuance of debt to finance these investments are: firstly, whether or not the Company's capacity to raise debt capital to finance its utility operations has been impaired; and, secondly, whether or not Westcoast's debt cost is adversely affected. Based on the evidence before it, the Board is of the view that Westcoast's investments in non-utility activities would neither diminish the Company's ability to raise debt for its utility operation nor would they cause increases in the debt costs of the utility in the test year.

Views of Mr. Illing

I agree with my colleagues that the deemed common equity ratio of Westcoast should be maintained at the currently approved level of 35 percent. However, I reached this conclusion on a somewhat different basis. In my view, there was only sufficient evidence presented in this proceeding to compare the business risks to which Westcoast is currently exposed with those at the time of the last toll proceeding which involved an uncontested settlement of the Company's application for 1993 tolls. I did

not find that the evidence comparing current risks to those at the time of the last proceeding justified any change to the existing equity ratio.

In my opinion, an analysis of changes to Westcoast's risks over a longer time horizon was not adequately examined in this case and should be more rigorously pursued in a future proceeding. It is too easy for pipeline companies and regulators to fall into the trap of a limited time frame analysis of the evolution of risk just as it is easy for business corporations and others to believe that the starting point for development of next year's budget is always appropriately last year's budget. As with the development of budgets, the evaluation of corporate risk would benefit, from time to time, from a searching review of how the world has really changed over a significant period of time. To do otherwise results in a myopic view and the possibility of unfairness to either the regulated company or affected parties.

I cannot associate myself with my colleagues' views regarding the comparison of TransCanada's pipeline system and Westcoast's. They recognized that any assessment of such differences is to a large extent judgmental in nature and placed only limited weight on this comparison in arriving at their decision regarding the appropriate deemed common equity ratio. I did not find sufficient evidence presented in this hearing to lead me to any supportable conclusion about the relative risks of Westcoast and TransCanada and therefore judgment of these relative risks was not a factor in my decision.

To summarize, I concur with my colleagues' decision concerning the 35 percent common equity ratio, but feel that the evidence adduced in this proceeding did not provide for an adequate examination of the changes in the risk profile of Westcoast over an extended time period. I found insufficient evidence to support a conclusion concerning differences in risks between Westcoast and TransCanada.

Decision

The Board approves a deemed common equity ratio of 35 percent for the 1994 test year.

4.2 Rate of Return on Common Equity

Westcoast applied for a rate of return on common equity of 12.5 percent based on test results and analysis of witnesses who relied on the comparable earnings, discounted cash flow ("DCF") and equity risk premium techniques, and placed weights of 30, 10 and 60 percent on each technique, respectively.

Westcoast's witnesses conducted a comparable earnings test and a DCF test, but, in both cases, stated that their results were highly speculative. Regarding the comparable earnings test, they suggested that their expectation of slow recovery of earnings in the first three years of the current cycle, which they set as 1992 to 2000, makes it difficult to estimate returns for the

current cycle. Regarding the DCF test, they stated that there are no objective measurements of investor growth expectations.

Under the comparable earnings test, based on data for a sample of 25 low-risk industrial companies over the period 1992 to 2000, including forecasts of analysts obtained from the Institutional Brokers Estimate System and other earnings assumptions, the witnesses found that the average return for the period would be in the range of 11.8-12.3 percent. They suggested, however, that, after the on-going industrial restructuring is complete, the level of earnings would be in the order of 13.0-13.5 percent. They adjusted this range downward a first time to 12.5-12.75 percent to account for the effects of the next recession, and a second time to a final result of 12.25-12.5 percent to reflect the lower risk of Westcoast.

Under the DCF test, using data for the same sample of 25 low risk industrials, they arrived at a long term rate of growth of approximately 9.0 percent. Adding this growth estimate to an adjusted for growth dividend yield of 2.7 percent gave them a "bare-bones" cost of 11.7 percent. This value was then adjusted downward to 11.4 percent to reflect the lower risk of Westcoast, and adjusted upward to a final result of 12.5 percent to allow for financing flexibility.

Regarding their risk premium test, Westcoast's witnesses carried out two types of studies. Under the first type, two studies were carried out where the risk premium was measured as the difference between the DCF cost of attracting equity for a sample of high grade utilities and the corresponding yield on long-term Government of Canada bonds ("long-Canada"); regression analysis was then used to estimate the prospective risk premium based on projected long-Canada rates. Westcoast claimed that these studies show that risk premium varies inversely with interest rate and positively with risk. Using the results of these studies and their forecast of Government bond yields in the range of 7.5-8.0 percent, with a mid point of 7.75 percent, they recommended that the equity risk premium for Westcoast should be no less than 4 percent.

Under the second type of study, two separate approaches were used. Under the first approach, the required premium for the market as a whole was estimated and then adjusted for the lower risk of Westcoast. From the analysis of four studies of Canadian security returns experienced over extended periods of time, the witnesses found that the market equity risk premium would be no less than 5 percent in the current environment. Their finding for Westcoast was for a downward adjustment of 30 percent based on the analysis of: beta figures, which measure systematic market risk; standard deviations of market returns, which measure total market risk; and the historic performance of gas and electric utilities relative to that of the market as a whole.

Under the second approach, the equity risk premium for Westcoast was directly estimated based on past achieved differentials between returns on utility stocks and long-Canadas. The results suggested an equity risk premium of no less than 3.5 percent for investments in high-grade utilities.

Based on the findings from their four studies and projected long-Canada rates of 7.5-8.0 percent, with a mid point of 7.75 percent, and an inverse relationship between interest rates and risk premium, Westcoast's witnesses estimated that the required risk premium for

Westcoast would be 3.875 percent. The resultant "bare-bones" cost of common equity was 11.625 percent, which was then adjusted to a final result of 12.7 percent to allow for financing flexibility.

They explained that the adjustment for financing flexibility would cover financing costs, an allowance for market pressure (or the tendency for the price of the stock to fall as an additional supply of stocks is introduced into the market) and an allowance for unforeseen market breaks. They also stated that the fairness principle warrants an adjustment inasmuch as a market-to-book ratio of 115 percent would recognize that, in their opinion, competitive industrials have, in periods of moderate inflation, consistently been able to maintain the real value of their assets as evidenced by market-to-book ratios significantly in excess of one.

CAPP et al jointly sponsored a witness who relied exclusively on the equity risk premium technique. He recommended a range of 10-10.75 percent, with an emphasis on the midpoint and upper end of the range. The witness did not rely on the comparable earnings test because, in his opinion, the test purports to measure something distinct from the cost of capital, as if the comparable return standard were an independent and unrelated concept. He also claimed that the measurement of comparable earnings based on accounting data provides results which are difficult to compare meaningfully across companies and across time. He added that the lengthy period over which significant rates of inflation were experienced requires one to consider whether past rates of return will continue, whether they are above or below competitive levels and whether the measurement process itself has validity today.

Regarding the DCF test, he stated that, because of the prolonged period over which corporate profits have either plummeted or remained stagnant, it is inappropriate to rely at this time on DCF results obtained by the application of conventional growth rate estimation methods to historical data for non-utility corporations. He carried out a DCF analysis for consistency proposes only.

Regarding the equity risk premium test, the witness for CAPP et al first estimated the risk premium for the equity market as a whole and used the results as a point of departure for estimating the risk premium for samples of lowest risk non-utilities and utilities and, eventually, Westcoast.

Relying on studies of rates of return which could have been achieved in the past from investments in portfolios of Canadian common stocks and investments in long-term bonds, he estimated that the average premium for the Canadian market over the period 1926-1992 was 3.7 percent. Giving primary weight to this finding, he estimated that the equity risk premium required prospectively by investors would be in the range of 4 to 4.5 percent. He settled on the higher end of this range, at 4.5 percent, in consideration of the somewhat higher result of 5.4 percent for the American market over the same period and the Canadian result of 4.3 percent for the 1950-1992 period.

By reference to the above 4.5 percent market risk premium, he estimated that the equity risk premium for his non-utility sample was in the order of two-thirds that of the equity market as a whole, or a risk premium of 3.0 percent. For his utility sample, he determined a lesser risk exposure of no more than half that of the equity market as a whole, or a risk premium of 2.25 percent.

Regarding the prospective long-Canada yield, he forecast a range of 7.5 to 8 percent based on the recent historical level of yields, the current "spot" yields, the yield implicit in the quoted prices for United States Treasury bond futures contracts and the spread between American and Canadian government long-term bonds.

Adding the risk premium of 2.25 percent for a low risk utility such as Westcoast to the above long-term bond yield, he arrived at an investor's required rate of return of 9.75 to 10.25 percent. To this result, he added a "cushion" of 25-50 basis points, with an emphasis on the upper end of that range, to account, as he explained, for uncertainties currently prevailing in financial markets and some skittishness in Canadian markets. He objected, though, to recognizing market breaks in setting an appropriate rate of return for Westcoast because he considered these breaks ephemeral and affecting share price only temporarily. He also argued that utilities tend not to be affected adversely by market breaks and that they could rely on bridge financing if need be.

His recommendation was then a rate of return on equity of 10.0-10.75 percent, with an emphasis on the midpoint and upper end of the range. He added that the premium inherent in his recommendation for the risks borne by common shareholders exceeded the equity risk premium higher of 2.25 to 3 percent by the amount of a purchasing power risk premium of long-term bond yields, which he estimated to be in the order of 75 to 125 basis points.

Views of the Board

In determining an appropriate allowable rate of return on average common equity for Westcoast in this proceeding, the Board gave very little weight to the results of the DCF test. Specifically, the Board is of the view that, under current market conditions, any estimate of the longer term expected growth rate in dividends is unreliable. The Board also takes the view that the current economic conditions, including expected inflation rates which are significantly lower than those in the past, render the results of the comparable earnings test speculative. The Board has, therefore, decided to place primary reliance on the results of the risk premium test.

With respect to the risk premium test, the Board notes that Westcoast's and CAPP et al's witnesses separately recommended yields on long-Canadas in the range of 7.5 to 8.0 percent. For the purpose of this proceeding, the Board has made its finding on rate of return on equity on the basis of a long-Canada yield within this range. Regarding the market risk premium, Westcoast's witnesses contended that it is no less than 5.0 percent, whereas CAPP et al's witness was of the opinion that it is approximately 4.5 percent. The Board notes that, in arriving at these results, the witnesses relied on some of the same studies. The Board is of the opinion that the current market risk premium lies in the range of 4.5 to 5 percent.

The witnesses disagreed on the magnitude of the reduction to the market risk premium required to reflect the lower risks of Westcoast. The Company's witnesses estimated that an appropriate downward adjustment would be in the order of 30 percent, whereas CAPP et al's witness contended that the adjustment should be of 50 percent. Based on their studies, Westcoast's witnesses recommended a 3.9 percent equity risk premium for Westcoast, whereas CAPP et al's witness recommended a premium in the range of

2.25 to 3.0 percent. Based on the Board's assessment of the risks to which the utility is exposed in relation to the market, the Board considers the adjustment proposed by CAPP et al to be somewhat excessive.

The witnesses disagreed on the size of the upward adjustment to the "bare-bone" returns intended to provide Westcoast with the financial flexibility to attract and retain common equity under a broad range of capital market conditions. Westcoast contended that a 100 basis points upward adjustment is required. CAPP et al recommended a "cushion" of 25 to 50 basis points for uncertainties currently prevailing in financial markets. While the Board believes that Westcoast should be allowed sufficient flexibility to finance its operations and planned expansions, it is not convinced that the allowance for unforeseen financial circumstances should reflect potential market breaks to a significant extent.

Having considered all of the evidence before it, the Board finds that a decrease in the allowable rate of return on equity from that granted in the RH-3-92 Reasons for Decision is warranted. The Board is of the opinion that a rate of return on common equity of 11.50 percent is fair and reasonable for the test year.

Decision

The Board approves a rate of return on common equity of 11.50 percent for the 1994 test year.

4.3 Other Capital Cost Rates

4.3.1 Funded Debt

Westcoast applied for a rate of 10.29 percent on a forecast funded debt balance of \$857,638,000 for 1994. The dollar amount of funded debt and the associated cost rate were determined using the net proceeds methodology approved by the Board in the RH-1-90 Reasons for Decision. No intervenor objected to the applied-for amount of funded debt and the associated cost rate.

Decision

The Board approves funded debt in the amount of \$857,638,000 and a rate of 10.29 percent for the 1994 test year.

4.3.2 Unfunded Debt

Westcoast applied for a cost rate of 8.65 percent on its forecast unfunded debt balance for the 1994 test-year of \$128,568,000. The applied-for rate is based on a forecast yield of 7.65 percent for a 20-year long-Canada for the test-year and a corporate issue spread of 100 basis

points, which, according to Westcoast, reflects the recent upgrade of its bond rating from BBB (High) to A (Low).

Westcoast explained that the use of a long-term rate recognizes that the assets to be financed are long-term in nature and that it permits the Company to choose the appropriate time to undertake a long-term issue. Further, Westcoast stated that it is appropriate to use a long-term debt rate because the Company will finance its unfunded debt balance during the test year.

CAPP et al and the APMC recommended that the Board use a blended rate which takes into consideration the use of both short-term and long-term financing during the test year and recommended a deferral account for the variance between forecast and actual rates. They explained that this approach will give Westcoast the latitude to fund long-term debt at the most appropriate point in time without being neither disadvantaged nor advantaged. Further, they claimed that, in 1994, short-term debt will represent a significant proportion of the Company's unfunded debt and that Westcoast's proposal would cause the return allowed on unfunded debt to exceed actual costs by \$1.4 million if the financing is carried out as expected.

Views of the Board

For some time, the Board has prescribed a long-term corporate rate as the cost rate for the unfunded debt of Westcoast. In the light of the continuing rapid expansion of the physical plant of Westcoast, however, the Board is persuaded that the Company's debt financing requirement is sufficiently large that it has to access the market frequently and that short-term debt will be used in the interim. As a result the Board is of the view that short-term instruments will be part of Westcoast's permanent financing for the foreseeable future. For this reason, the Board considers it appropriate to adopt as the cost rate for Westcoast's unfunded debt for 1994 a blended rate of 7.44 percent, which is based on the Company's plan for issuing long-term debt instruments in July and September 1994 to finance its unfunded debt balance. In determining this unfunded debt rate, the Board has determined, based on the forecast yield for long-Canadas and the corporate issuance spread, that a reasonable cost rate for the Company's corporate debt cost would be 8.5 percent. The Board also estimated that the Company's short-term debt cost would be approximately five percent.

Regarding the unfunded debt rate deferral account as proposed by CAPP et al, the Board is of the view that such a deferral account is inappropriate in this instance where costs can reasonably be forecast. The Board is satisfied that rigorous scrutiny in toll proceedings of Westcoast's applied-for rate will provide adequate assurance that Westcoast would only recover an unfunded debt cost that is fair and reasonable.

Decision

The Board approves an unfunded debt cost rate of 7.44 percent for Westcoast for the 1994 test year and denies CAPP et al's proposal for an unfunded debt rate deferral account.

4.3.3 Preferred Share Capital

In its application Westcoast continued to allocate the entire \$35 million issue of 7.68 percent preferred shares to the utility operation of the Company. Using the modified net proceeds methodology approved by the Board in its RH-2-89 Reasons for Decision, Westcoast applied for a cost rate of 7.94 percent on a preferred share balance of \$34,881,000 for the 1994 test year. No intervenor objected to the applied-for amount of preferred share capital and the associated cost rate.

Decision

The Board approves preferred share capital in the amount of \$34,881,000 and a cost rate of 7.94 percent for the 1994 test year.

4.4 Rate of Return on Rate Base

Decision

Based on the decisions contained in these Reasons for Decision, the Board has estimated a rate of return on rate base of 10.48 percent for the 1994 test year. The approved capital structure and overall rate of return as estimated by the Board are shown in Table 4.2.

Table 4-2

**Approved Deemed Average Capital Structure
and Rates of Return for the 1994 Test Year**

	<u>Amount</u> (\$000)	<u>Capital</u> <u>Structure</u> (%)	<u>Cost</u> <u>Rate</u> (%)	<u>Cost</u> <u>Component</u> (%)
Debt - Funded	857,638	56.13	10.29	5.78
- Unfunded	<u>100,684</u>	<u>6.59</u>	7.44	<u>0.49</u>
Total Debt Capital	958,322	62.72		6.27
Preferred Share Capital	34,881	2.28	7.94	0.18
Common Equity	<u>534,802</u>	<u>35.00</u>	11.50	<u>4.03</u>
Total Capitalization	<u>1,528,005</u>	<u>100.00</u>		
Rate of Return on Rate Base				<u>10.48</u>

4.5 Income Tax Provision on Flow-through Basis

In its provision for income tax calculated on a flow-through basis, Westcoast included the B.C. Corporation Capital Tax. Previously, this tax had been grouped with Taxes Other than Income Taxes. However, because it is a tax on capital, Westcoast proposed that it be accounted for on the same basis as the federal Large Corporations Tax.

Views of the Board

The Board notes that the B.C. Corporation Capital Tax was first introduced by the provincial government in 1992. The 1991 federal budget included a proposal to limit the impact of deductible provincial payroll and capital taxes on federal revenue without adding to the overall tax burden. This has been the subject of negotiations between the federal and provincial governments and, pending solution of the matter, an interim proposal was developed, effective 1 January 1994, to limit the impact of any increases in these taxes.

According to a news release dated 1 October 1993 issued by the federal Department of Finance, implementation of the final proposal has been delayed until 1 January 1995 and the interim proposal will continue in the meantime. As there is no change in the method of calculating the B.C. Corporation Capital Tax, the Board is of the view that the tax should not be included as an item in the calculation of the Westcoast Utility Taxable Income.

The Board has estimated the financial impact of the decisions contained in these Reasons for Decision. This has included adjusting the "return related to equity" amount (see Table 4.3) to reflect the rate of return on equity approved by the Board, and the removal of the B.C. Corporation Capital Tax from the calculation of the Westcoast Utility Taxable Income. This has been offset by a reduction in the estimated amount of the Capital Cost Allowance to adjust the Utility Taxable Income to zero. With respect to the 1994 income tax provision on a flow-through basis, the Board notes that no drawdown of the deferred income tax balance, as approved in the RH-1-92 Reasons for Decision, will be required because the utility taxable income is already zero.

Decision

The Board has adjusted Westcoast's 1994 income tax provision on a flow-through basis to reflect the decisions contained in these Reasons for Decision.

For the 1994 test year, the utility income tax provision will consist of the federal Large Corporations Tax and the B.C. Corporation Capital Tax, which the Board estimates at \$8.6 million.

Table 4-3
Utility Income Tax Allowance
for the 1994 Test Year

(\$000)

	Application ¹	Board Adjustments	Approved (Estimated)
Return Related to Equity	63,334	(7,675)	55,659
Add (Deduct):			
Prior Year Deferral Carrying Charge	(550)	-	(550)
AFUDC - Interest Portion	(12,586)	2,143	(10,173)
Depreciation	46,776	(700)	46,076
Amortization	180	-	180
Amortization of Issue Costs	1,023	-	1,023
Financing Expenses	(1,705)	-	(1,705)
Capital Cost Allowance	(97,561)	9,473	(88,088)
Overhead During Construction	(8,231)	1,423	(6,808)
Cumulative Eligible Capital	(51)	-	(51)
Foreign Exchange Loss on Debt Redemptions	889	-	889
Pension Payments	(4,860)	-	(4,860)
Pension Accrual	4,860	-	4,860
Disallowable Expenses	270	-	270
Large Corporations Tax	3,638	-	3,638
Rate Case Expense Payments	(360)	-	(360)
B.C. Corporation Capital Tax	<u>4,934</u>	<u>(4,934)</u>	<u>-</u>
Utility Taxable Income	<u>-</u>	<u>-</u>	<u>-</u>
Income Taxes	-	-	-
Add: Large Corporations Tax	3,638	-	3,638
B.C. Corporation Capital Tax	<u>4,958</u>	-	<u>4,958</u>
Utility Income Tax Provision	<u>8,596</u>	-	<u>8,596</u>

¹ Estimated based on filing as revised on 15 October 1993

Chapter 5

Operating Costs

Westcoast estimated its test-year operating and maintenance ("O & M") expenses to be \$127.1 million for the 1994 test year, for an increase of \$3.9 million, or 3.2 percent higher than the forecast of \$123.2 million for the 1993 test year.

5.1 Salaries, Wages, Employee Benefits and Escalation Factors

5.1.1 Person Year Utilization and Overtime

For 1994, Westcoast projected a utilization of 1,137 person years ("PY"), net of a vacancy adjustment of 17 PYs, as compared to the 1993 forecast of 1,132 PYs, net of a vacancy adjustment of 9 PYs. The Company explained that the net increase of 5 PYs and an increase in overtime of \$296,000 were attributable to new pipeline facilities, the expansion of the Pine River processing plant, increased activity in the Vancouver departments, the staffing of undercomplemented areas in the field and the higher level of maintenance work associated with the high throughput forecasted for 1994.

COFI argued that the improved efficiency and reduction in personnel costs that Westcoast used to justify investments in new facilities have not materialized and recommended that the \$3.2 million increase in expenses related to staff additions, overtime and general increases be reduced by half.

5.1.2 Year-Over-Year Salary and Wage Increases

For the 1994 test year Westcoast proposed an overall year-over-year salary increase of 3.5 percent, broken down between 3.0 percent for the basic budget portion and 0.5 percent for salary progression and pay equity adjustments. Westcoast also proposed a wage increase of 3.0 percent. Further, the Company forecasted an increase in bonuses from \$410,000 in 1993 to \$425,000 in 1994, an increase of 3.7 percent.

In support of its proposed salary increase, Westcoast considered the 2.0 percent increase approved by the Board for 1993 to be significantly below the pipeline industry average increase of 2.7 percent for that year. Comparing recent salary levels with those of other companies, Westcoast contended that its salaried employees were being paid, on average, below Westcoast's target level of market average. Westcoast also stressed that its 1994 requested salary increase was in line with the forecast year-over-year increases in Consumer Price Indices for British Columbia and Vancouver, estimated at 3.8 and 4.1 percent, respectively.

To support its proposed wage increase, Westcoast anticipated continuing its practice of following the national pattern negotiated in the industry. Also, the Company referred to the bargaining position of a 3 percent increase that was proposed by the union representing

employees at the Fort Nelson and McMahon plants and the fact that the Fort Nelson employees rejected the increase as being too low.

CAPP, who was supported by BC Gas, recommended an overall salary increase of 2.5 percent for all forms of remuneration, including bonuses and "other remuneration", which, it argued, falls between the low end and the high end of the results from recent salary studies. COFI recommended a 2 percent increase for both salaries and wages, to be applied to the total pool of employee remuneration, including bonuses and "other remuneration". COFI stated that its recommendation took into account the expected industry wage and salary increases of close to 1.5 and 2.0 percent, respectively, for 1994 and an allowance for pay equity.

5.1.3 Base Year Salary Level

To determine the 1992 base-year salary figures found in its application, Westcoast used, not the 2.5 percent increase over 1991 salaries approved by the Board for that year, but the actual salary increase of 3.44 percent that it awarded its employees. As a result, the base-year salaries, wages and benefits were higher than the Board-approved level by approximately \$314,000.

For the 1993 salary figures, Westcoast used the 2.0 percent salary increase included as part of the tolls settlement approved by the Board for that year. However, it noted that other companies in similar sectors offered increases that averaged considerably higher.

COFI recommended that the Board direct Westcoast to use the total amount of salaries for the 1992 base year that the Board approved in the RH-1-90 Reasons for Decision and which is implicit in the RH-1-92 Decision.

5.1.4 Escalation Factors and General Inflation

Westcoast used escalation factors ranging from 0 to 8 percent for selected materials and chemicals and a 3 percent general inflation factor for other cost of service items. Westcoast contacted its suppliers to determine the specific escalation factors and relied on economic forecasts such as the Consumer Price Index in determining the general inflation factor.

COFI contended that the general inflation factor used by Westcoast was higher than the 2.2 percent forecast of Westcoast's own witnesses on financial matters. COFI recommended 1.5 percent based on the mid-point of the low and high ends of the forecast inflation rates discussed at the hearing.

5.2 Other Expense Items

During the hearing, intervenors expressed general concerns with regard to Westcoast's 1994 O & M expense forecast and questioned in detail several specific expense items, some of which are discussed below.

Directors' Fees and Supplemental Pensions

Intervenors cross-examined Westcoast extensively on supplemental pension payments made to the former Chairman of the Board of Directors upon his retirement and the subsequent increase in Directors' fees. Westcoast justified the increases by referring to the election of two additional directors, additional meetings and additional expenses. CAPP also questioned why shippers should pay for directors from across the country to represent the interests of utility operations based in British Columbia. CAPP recommended that Directors fees and related travel expenses be reduced by at least 50 percent.

COFI agreed with CAPP's position on directors fees. It also recommended that the provision for supplemental pensions be disallowed on the basis that Westcoast did not provide evidence to support this cost.

Industry and Association Dues and Charitable Donations

Industry and Association Dues are forecast to increase by \$126,000 over 1993, to a total of \$531,000 for 1994. Charitable donations are forecast to increase by \$15,000, to a total of \$415,000 for 1994.

CAPP, who was supported by COFI, proposed that Westcoast be required to allocate 50 percent of the total dues and charitable donations to its non-utility operations. Westcoast argued, however, that the association dues are justified in terms of benefits to the utility and that its non-utility subsidiaries, as stand-alone entities, are responsible for their own association dues and charitable donations.

Portland Office

In April 1993, Westcoast opened an office in Portland, for which it forecasted costs of \$57,978 in 1993 and \$87,516 in 1994. Westcoast argued that the office is a modest initiative to facilitate improved communication and input from its export customers, which represent half of its customer base, and promote maximum utilization of the pipeline.

A number of intervenors argued that the function of communication and interaction with players in the marketplace is the responsibility of Westcoast's customers, not Westcoast, and suggested that the Board disallow the cost of the Portland office. BC Gas further suggested that Westcoast's shareholders absorb the cost of winding down operations in Portland.

McHenry and Staffier Legal Consultation

In forecasting its General Administrative costs for the Vancouver departments, Westcoast included legal consultation fees of \$310,000 for the services of McHenry and Staffier, a law firm based in the U.S.

CAPP, supported by COFI, claimed that these fees are not legitimate utility costs today and recommended that they be disallowed. BC Gas expressed concern that the inclusion of this cost over the last few years may reflect Westcoast's previous role as a seller of gas. BC Gas recommended recording the costs in a deferral account to allow toll payers to review the prudence of these expenditures in future toll hearings.

Environmental Expenses

Environmental fees were forecasted to exceed \$960,000 in 1994, in contrast to \$28,000 forecast for 1993. Westcoast stated that the increase results from changes in the methodology used by the British Columbia Government for determining permit fees and increased quality assurance expenditures.

EUG questioned Westcoast on its efforts to control these expenses, suggesting that the Company meet with the provincial government and reduce the emissions causing the costs.

BC Gas noted the increase in fees and expressed concern that inappropriate environmental costs, such as costs resulting from imprudent activities by the pipeline or a third party, should not be borne by toll payers. BC Gas referred to Westcoast's purchase of facilities at the McMahon Plant from Petro-Canada and the concern that the Board expressed in the RH-1-92 Reasons for Decision that no environmental audit had been performed. BC Gas noted that no subsequent audit was performed and recommended that the Board direct Westcoast to conduct an audit to fix responsibility for damages and determine the portion of costs to be borne by Petro-Canada.

5.3 Capitalization of Salaries and Overhead

Westcoast was questioned on its practice of capitalizing salaries and overhead and on the amounts that were capitalized in recent years. Westcoast explained that, from the time that it was put under the regulation of the Board, it has been capitalizing salaries and expenses on a historical percentage basis, not on a project-by-project basis.

CAPP was concerned that, when Westcoast determines its capitalization rate, it seems to rely on estimates which are never checked against actual results. CAPP also questioned whether Westcoast's approach conforms with subsection 26(2) of the Gas Pipeline Uniform Accounting Regulations ("GPUAR"), which stipulates that only actual and reasonable overhead costs shall be assigned to particular jobs or units. CAPP recommended that Westcoast be directed to adhere to the GPUAR by only capitalizing actual salaries and overhead to specific projects, and to change its practices relating to capitalization. CAPP suggested that GPIS final entries into rate base should be subject to review at a subsequent rate case to ensure that they are reasonable. CAPP also proposed that the Board should either set a fixed percentage limit for overhead or require Westcoast to submit what the appropriate ceiling percentage should be. CAPP suggested that this issue be specifically addressed in future audits by the Board.

COFI agreed with CAPP's argument and added that, not only are total costs for Vancouver departments increasing, but also the costs being capitalized are accelerating, causing increases

in the cost of service to appear more reasonable. COFI recommended that the Board disallow half of the requested increase in capitalization for 1994.

COFI also pointed out that all cost groups associated with the Vancouver departments are forecast to increase in 1994 and that these increases show that the savings claimed by Westcoast as a result of using more efficient computer systems will not occur. As a result, COFI suggested that the related cost forecast for Vancouver departments be reduced by 50 percent. Westcoast responded that the increases were justified because of the very large capital program in effect recently and stated that its capitalization procedures conform to the GPUAR.

In addition, COFI was concerned that Westcoast uses more operations people to work on capital projects than what was forecast. COFI explained that this practice would allow the Company to recover the cost of the affected employees once through that year's O & M expenses and once again in a later year through rate base.

COFI referred to a similar situation in Trans Mountain's RH-3-91 proceeding where a significant amount of O & M salaries was transferred to capital projects while discretionary maintenance work had been deferred to the following year. In the light of the materiality of the associated variance, the Board directed Trans Mountain to reduce GPIS by the amount transferred to rate base projects. COFI recommended that the Board not permit Westcoast to continue to capitalize operations employee time which exceed the forecast.

Views of the Board

The Board recognizes that, under the current established cost of service approach, interested parties have little choice but to examine in detail the proposed O & M expenses of Westcoast in their attempt to ensure that the Company is managed and operated in an efficient manner and that tolls remain competitive. However, interested parties have advocated that some form of general cost restraint be found to challenge the Company "to find ways to do more with less".

Although expenditures are subject to review and examination by the Board and interested parties in toll proceedings, in the Board's view, the Company is ultimately responsible for determining where and how available resources are to be expended. Consequently, the Board finds it more appropriate and practical not to make numerous specific findings on items of O & M expenses. Instead, the Board will, in this instance, approve a global O & M amount for toll setting purposes which Westcoast can allocate to different budget items as it sees fit. For 1994 revenue requirement purposes, the Board has determined that the O & M expenses should be reduced by \$1.1 million from the applied-for level, thus establishing the budget at \$126.0 million.

In arriving at this figure, the Board has considered the evidence and argument presented. More specifically, and in order to provide guidance for future hearings, but without restricting the generality of the foregoing, the Board has taken the following into consideration.

The Board is of the view that the applied-for increases in PYs and overtime are reasonable given the expected increases in throughput and construction activities for the test year.

Based on the national, provincial and industrial estimated averages for salary increases on the record, the Board finds reasonable a more moderate increase of 2.5 percent instead of the requested increase. Regarding wages, the Board has taken into consideration industry trends as well as recent public and private sector wage settlements and has determined that a 2.5 percent increase in wages is more reflective of current conditions. The Board is of the view that bonuses should be limited to a similar increase and be treated as a separate component of remuneration.

The Board considers that, with the approach used in this proceeding to evaluate O & M expenses, a new base for determining salaries has been established. Accordingly, the Board has accepted the use of actual 1992 increases by the Company in determining an appropriate total O & M figure for the 1994 test year.

Regarding the general inflation factor used for budgeting purposes, the Board has given weight to the evidence of Westcoast's witnesses on financial matters and considers a general inflation factor of 2.25 percent reasonable.

In today's business environment, Westcoast must be cost efficient and must exercise restraint when it determines its budget for operating costs. Based on the evidence before it, the Board is of the view that some proposed O & M items could have reflected more determination on the part of the Company to exercise cost restraint. For these reasons, the Board has determined that the applied-for O & M expenses should be reduced to reflect this inadequacy.

In respect of capitalization of salaries and overhead, the Board has reviewed the manner in which Westcoast identifies those costs for budgeting purposes and finds that the procedures employed do not contravene the requirements of the GPUAR. The proposal from intervenors that the Company should implement a system of tracking actual costs on a project-by-project basis, requiring the recording of much more detailed time sheets by affected staff, raises the question of the cost effectiveness of such an undertaking. The Board urges Westcoast to pursue cost effective means to reflect employee time utilization as closely as is practical in determining its factors for allocating costs between O & M expenses and capital projects. To this end, the recommendations contained in the Arthur Andersen Cost Allocation Study may be helpful.

Although specific incidents of double-counting an expenditure as an O & M expense and again as a capitalized item as suggested by COFI were not identified in this proceeding, the fact that intervenors believe that this could happen is of concern to the Board. Accordingly, the Board plans to closely monitor the situation to ensure that the Company follows a consistent capitalization and expensing policy. In this proceeding, some intervenors expressed concerns with Westcoast's allocation of costs to its non-utility activities. The Board notes that the Company is in the process of developing a new cost allocation approach based on the recommendations of Arthur Andersen &

Co. The Board expects Westcoast to file for review in the next toll proceeding revised allocation procedures which take into consideration the findings of the Arthur Andersen study and the concerns expressed by the intervenors in this proceeding.

As the Board indicated above, it recognizes that Westcoast operates in a dynamic, rapidly changing market place and believes that the decision as to how to specifically manage its O & M budget for 1994 should be left to Westcoast. It is anticipated that under this approach of the Board the Company's management will have greater flexibility to quickly and effectively adapt to changing circumstances while striving for more efficient operations. Accordingly, the Board expects variances to occur between the amounts forecasted by the Company for O & M expenses and those actually incurred as a result of changed circumstances emerging after the hearing and during the test year.

To the extent that 1994 actual amounts will underpin the base year figure in a future tolls hearing, those actual amounts will be examined and tested to determine the extent to which they form an appropriate foundation for the test year being considered at that time. In keeping with this approach, the Board expects Westcoast to file information in its next application that will provide variance analysis and also to be prepared to defend the applied-for amounts in their entirety and not only on the basis of year-to-year changes.

With respect to the request of BC Gas that the Board direct Westcoast to conduct an environmental audit of the McMahon Plant, the Board reiterates its views expressed in the RH-1-92 Reasons for Decision and does not consider it appropriate to make such a direction at this time.

With respect to the positions advanced by Ron Dickson Labour Consulting and the British Columbia Provincial Council of Carpenters, the Board acknowledges that "when inefficiencies affect Westcoast's costs of operating the utility, then it becomes the business of the National Energy Board and its shippers". The Board finds, however, that there has been no evidence adduced during this proceeding to suggest that Westcoast has engaged in discriminatory hiring practices and, more importantly and more germane to this proceeding, the Board finds that the unions have not demonstrated that Westcoast's hiring practices or any such alleged discrimination has had an adverse impact upon Westcoast's costs. Furthermore, the unions' allegations that Westcoast's behaviour is contrary to human rights law and the Criminal Code of Canada is not within the jurisdiction of this Board and are clearly outside the scope of a tolls proceeding under Part IV of the Act.

Decision

For toll setting purposes, the Board approves O & M expenses in the amount of \$126.0 million.

Chapter 6

Toll Design and Tariff Matters

6.1 Throughput Forecast

Westcoast forecast an annual system throughput of $16\,567.4\,10^6\text{m}^3$ or 584.8 Bcf for the 1994 test year, approximately 46 percent of which is for the export market.

Decision

The Board finds Westcoast's 1994 test year throughput forecast to be reasonable and accepts it for cost allocation and toll design purposes.

6.2 Daily Billing

In the RH-1-89 Reasons for Decision, the Board directed Westcoast to implement, by 1 January 1992, a system of daily billing for zones 3 and 4 in which shippers would be billed for the actual volumes of interruptible gas taken each day. Daily billing was intended to replace the then existing billing arrangements. At that time, a shipper who had not utilized its full monthly volume entitlement under its firm service agreement for a zone and who had also incurred interruptible service at an alternate location within the same zone would be eligible for a service credit that would reduce, if not eliminate, its charges for interruptible service.

On 20 December 1991, the Board approved a request from Westcoast to defer implementation of daily billing. The Board directed Westcoast to review its bills for the 1990-91 heating season to determine whether any shipper had abused the billing procedures. In August 1992, Westcoast submitted that no shipper had abused the billing procedures and asked the Board to further defer implementation of daily billing. The Board again approved Westcoast's request, but indicated that it intended to re-examine this issue in a future toll hearing.

In this proceeding, Westcoast stated that no steps had been taken to implement daily billing of interruptible volumes because no shipper had requested a change from the current billing procedures. Westcoast added, however, that it was prepared to follow the preference of shippers on this matter.

Westcoast also related the comments of a shipper who was in favour of daily billing but who no longer considers that a change is necessary. According to Westcoast, this shipper expressed the view that the operating characteristics of Westcoast have changed since the RH-1-89 proceeding. For instance, at that time, Westcoast was still involved in sales of gas. There was a concern that sales customers might use a service agreement to meet their peaking requirements. Further, the level of utilization of the Westcoast system is higher today and interruptible volumes are much lower.

COFI stated that it agrees with Westcoast that no problem exists with the current system of interruptible billing based on monthly usage. It added that it would be unnecessarily expensive and complex to introduce daily billing. BC Gas submitted that the implementation of daily billing should continue to be deferred unless Westcoast has cogent evidence of abuse.

Views of the Board

The Board is of the view that circumstances under which Westcoast operates have sufficiently changed since the RH-1-89 proceeding that a system of daily billing of interruptible volumes is no longer required. The Board notes, in particular, that the utilization level of the Westcoast system is significantly higher now. As a result, it is unlikely that shippers who have contracted for both firm and interruptible service would be able to avail themselves of benefits not available to shippers who contracted for either firm or interruptible service only.

Decision

The Board rescinds its direction in the RH-1-89 Reasons for Decision concerning the implementation of daily billing in Zones 3 and 4.

6.3 Renomination Procedures

Since the RH-3-92 proceeding, Westcoast has been discussing appropriate terms and procedures for a renomination service with members of the Joint Industry Operating Task Force. Westcoast explained that, so far, parties agreed on the need for a renomination system and the conditions that would apply when renominations involve an increase in authorized volume, but have not yet reached agreement where renominations involve a decrease in authorized volume. Westcoast indicated that the unresolved issue is whether the upstream (producer) shippers involved should have the right to confirm a downward renomination requested by a downstream buyer.

Westcoast, who was supported by CAPP, submitted that the producer shippers should have the right to confirm a renomination because they are the parties who contracted for services with Westcoast and hold the gas sales contracts. Regarding situations where a producer shipper might not agree to a downward renomination, Westcoast submitted that it is up to the downstream interconnected pipelines to set up appropriate arrangements with its shippers to ensure that downward renominations will be workable.

BC Gas, who was supported by COFI, submitted that shippers should not have the right to refuse buyers' downward renominations. BC Gas contended that, otherwise, if Westcoast should refuse a downward renomination because producer shippers failed to confirm it, an imbalance could occur at the delivery end of the system if no downstream interconnect is willing to take the quantity of gas associated with the requested decrease in nomination.

BC Gas explained that, since Westcoast moved to previous day nominations, it has been experiencing nearly a 50 percent increase in demand forecasting error. It elaborated that, though it has been able to mitigate much of the impact of these potential imbalances on

Westcoast's system, it could not always do so without the capability for downward renominations. BC Gas also contended that renominations are primarily a supply issue to be agreed upon between buyers and sellers of gas and that, in case of a disagreement in renomination, Westcoast should side with what directionally results in eliminating or reducing the potential imbalance. It also expressed the concern that Westcoast's proposal will have the effect of granting to producer shippers an ability to extract contractual concessions from consumer shippers such as BC Gas.

Views of the Board

While the Board appreciates the concerns expressed by BC Gas regarding its exposure to imbalances, it is of the opinion that the Company should be allowed to implement a renomination procedures which gives the final say to shippers who have contracted for services on the Westcoast system.

Decision

The Board directs Westcoast to implement a renomination service as soon as possible and in any case no later than 31 October 1994. The Board directs Westcoast to file, for approval, appropriate revisions to the General Terms and Conditions - Service, including a provision giving shippers the right to accept or reject any renomination.

Chapter 7

Deferral Accounts

7.1 Disposition of Existing Deferral Account Balances

7.1.1 Accounts authorized in RH-3-92

In the RH-3-92 Reasons for Decision, the Board authorized certain cost of service and revenue deferral accounts for the 1993 test year. In this proceeding, Westcoast provided forecast balances of these deferral accounts as at 31 December 1993. With respect to these forecast 1993 year-end balances, the Company proposed to credit or debit these balances to the 1994 cost of service of the appropriate toll zones and functions.

Regarding any differences between forecast and actual deferral account balances for 1993, Westcoast applied for authorization to record such differences in the respective cost of service and revenue deferral accounts authorized for 1994.

With one exception the intervenors expressed no concerns with the proposed disposition.

Petro-Canada took issue with Westcoast's proposal to credit the 1993 year-end balance in the LPSF Service Revenue Variance deferral account to the cost of service attributable to the three functions of treatment, liquids recovery and LPSF carried out in Zone 2. In Petro-Canada's view, based on the "user pay" principle, the account balance should be credited only to the LPSF function.

Further, Petro-Canada contended that the current hearing is the first opportunity to examine the actual 1992 year-end amount in the LPSF Revenue Variance deferral account or to review the methodology proposed by Westcoast for the disposition of the balance in this deferral account. Petro-Canada requested that the portion of the actual 1992 year-end balance of \$271,000 in the LPSF Revenue Variance deferral account which has not been credited to the LPSF cost of service should be allocated to the 1994 LPSF cost of service. It also argued that a variance as high as \$271,000, or some 8.6 percent of the 1992 LPSF cost of service, suggests that the LPSF tolls originally set were not reasonable.

Views of the Board

With the exception discussed below, the Board accepts the disposition of the deferral account balances as at 31 December 1993 as proposed by Westcoast.

Regarding the 1993 year-end balance of the LPSF Service Revenue Variance deferral account, the Board notes that Westcoast's proposal would result in all of the processing functions, namely, treatment, liquids recovery and LPSF, receiving credits even though the overcollection arose only from actual LPSF volumes being higher than forecast in 1993. In the Board's view, Petro-Canada's proposal of crediting the

forecast 1993 year-end balance to the 1994 cost of service related to the provision of LPSF Service is preferable because it better reflects the cost causation principle.

Turning to the 1992 year-end balance of the LPSF Service Revenue Variance deferral account, the Board notes that in its application for 1993 tolls, Westcoast proposed to allocate the forecast 1992 year-end amount to the treatment, liquids recovery and LPSF functions. This proposal was reviewed in the RH-3-92 hearing which involved an uncontested settlement. In the RH-3-92 Reasons for Decision, the Board approved the Company's proposal. Subsequently, treatment, liquids recovery and LPSF tolls for 1993, which were based in part on the forecast 1992 year-end amount, were filed, approved and implemented. As well, revenues based on these tolls were collected.

In view of the foregoing and in the interest of toll certainty, the Board does not consider it appropriate to revisit these 1993 tolls. Nevertheless, the Board is of the view that difference between forecast and actual 1992 year-end balances (approximately \$9,000) of the LPSF service revenue variance deferral account, should be allocated to the 1994 LPSF cost of service only.

Decision

Except as noted below, the Board approves the disposition of the existing deferral account balances as at 31 December 1993, including the deferral of variances between the actual and forecast account balances, as proposed by Westcoast.

Regarding the 1993 year-end balance of the LPSF Service Revenue Variance deferral account, the Board approves Petro-Canada's proposal of crediting the forecast 1993 year-end balance to the 1994 cost of service related to the provision of LPSF Service.

The Board directs that the difference between the forecast and the actual 1992 year-end balances of the LPSF Service Revenue Variance deferral account be applied to the 1994 LPSF cost of service.

7.1.2 Cost Allocation Study

By letter dated 15 January 1993, the Board approved the establishment of a deferral account to record the costs of retaining outside consultants to carry out a study of cost allocation between the utility and non-utility activities as directed by the Board in the RH-1-92 Reasons for Decision. Westcoast secured the services of Arthur Andersen & Co. In this application, Westcoast requested that the 1993 year-end forecast balance of \$157,000, being the consultant's costs plus carrying charges, be recovered in the 1994 cost of service on the same basis as the allocation of general administrative costs in 1993.

Westcoast stated that, since the study was required by the Board, the consultants' costs should, therefore, be included in the cost of service. Nevertheless, should the Board be persuaded that some portion of the cost is to be borne by Westcoast's non-jurisdictional activities, Westcoast

took the position that the allocation should be based on the proportion of utility and non-jurisdictional costs which are the subject of the study. According to Westcoast, this approach would result in 84.5 per cent of the study cost being borne by the utility and the rest, by the non-jurisdictional activities.

Views of the Board

The Board is of the view that the consultant's costs pertaining to the cost allocation study should not be entirely borne by the utility operations of Westcoast. In rendering its decision, the Board considered that cost allocation has been an on-going issue in Westcoast toll proceedings mainly because of Westcoast's preference to operate Westcoast Energy Inc. as both an operating company and a holding company which provides corporate services to Westcoast's subsidiaries and other non-utility operations. In the Board's view, a share of the consultant's costs should be allocated to the non-utility.

As for the appropriate proportion, the Board has considered the approaches proposed by the parties and finds that allocating 25 percent of the consultant's costs to non-utility activities to be reasonable.

Decision

The Board approves for inclusion in the 1994 cost of service 75 percent of the balance in the utility/non-utility cost allocation study costs deferral account.

7.1.3 Demand Charge Credits for 1992 and 1993

By letters dated 6 May and 10 June 1993, the Board approved deferral accounts to record, without carrying charges, any demand charge credits paid by Westcoast in respect of shortfalls in deliveries of gas caused by construction of facilities in 1992 and 1993, respectively. Westcoast proposed that these account balances be capitalized as part of the cost of the capital projects to which the credits relate.

No intervenor took issue with Westcoast's proposal.

Decision

The Board approves the capitalization, as part of the applicable capital projects, of the balances in the deferral accounts which recorded the demand charge credits paid by Westcoast in respect of shortfalls in deliveries of gas caused by construction of facilities in 1992 and 1993.

7.2 Continuation of Existing Deferral Accounts

For the 1994 test year, Westcoast applied for authorization to continue the cost of service and revenue deferral accounts listed below. All of these deferral accounts were previously approved. In accordance with the settlement on Westcoast's application for 1993 tolls, the Company did not seek to renew the unfunded debt rate deferral account approved in the RH-3-92 proceeding.

Cost of Service Deferral Accounts

Property Taxes
Tax related to Fuel Consumption
Federal Surtaxes and Income Taxes
Provincial Surtaxes and Income Taxes
Corporation Capital Tax
Foreign Exchange
NEB Cost Recovery
Zone 2 Demand Charge Credits
Pressure Vessel Inspections and Repairs
Swing Gas

Revenue Deferral Accounts

Contract Demand Volumes
Interruptible Revenue
Liquid Products Stabilization and Fractionation Service Revenue Variance

None of the intervenors expressed concerns regarding the continuation of the deferral accounts listed above.

Decision

The Board approves the continuation of the cost of service and revenue deferral accounts listed above for the 1994 test year.

7.3 Demand Charge Credits for 1994

During the hearing, together with its request to amend its General Terms and Conditions regarding contract demand credits, Westcoast applied for a 1994 deferral account to record, without carrying charges, any demand charge credits paid by Westcoast in respect of curtailment of firm service caused by construction of facilities in 1994. The disposition of any balance in this deferral account will be considered by the Board in the next toll proceeding.

Decision

The Board approves the requested demand charge credits deferral account for the 1994 test year.

7.4 Unfunded Debt Rate Deferral Account

Regarding the unfunded debt rate for 1994, CAPP et al recommended a deferral account to record the difference between forecast and actual rates. This matter is discussed in the Chapter 4, Capital Structure and Cost of Capital, section 4.3.2.

7

Chapter 8

Interim and Final Tolls

By Order TGI-5-93 dated 23 December 1993, the Board approved tolls that the Company may charge for services provided to customers on the Westcoast system on an interim basis effective 1 January 1994. These applied-for tolls would yield a decrease of one percent for a typical export service movement from Zone 1 to the point of export of Zone 4.

The Board continues to take the view that final tolls for 1994 should be uniform, in the sense of being charged at the same level throughout the year. The Board has estimated that final tolls for 1994 set in this manner would give rise to a decrease of approximately 4.5 percent over the 1993 tolls for a typical export service movement. Westcoast will be required to refund to its customers the difference between the tolls resulting from these Reasons for Decision and those approved on an interim basis by Order TGI-5-93, together with carrying charges at the approved rate of return on rate base for 1994.

The Board notes that since 1991 both the throughput and the rate base have increased nearly 50 percent. Over this time period, tolls for a typical export service movement increased 2.5 percent in 1992 and one percent in 1993, and will decrease by approximately 4.5 percent in 1994. The Board is of the view that containing increases in revenue requirement and tolls while ensuring that the pipeline is being operated safely and efficiently should continue to be a primary focus of regulating the tolls of an expanding pipeline system such as Westcoast. The Board is cognizant of the fact that the main aspects of the Company's revenue requirement for which the Company can and should exercise rigorous control are operating and maintenance expenses and the costs of certain capital resources and of capital projects. The Board expects that Westcoast will strive to restrain increases in these costs, particularly its O & M expenses, in order to achieve moderate toll adjustments in the future.

Decision

The Board intends to approve final tolls for 1994 which are uniform throughout the 1994 calendar year. Westcoast is directed to refund to its customers or, where applicable, recover from its customers, the difference between the tolls resulting from these Reasons for Decision and those approved on an interim basis by Order TGI-5-93, together with carrying charges at the rate of return on rate base approved for 1994.

Chapter 9

Further Filings by Westcoast


In these Reasons for Decision, the Board has estimated the impact of its decisions on the Company's 1994 cost of service and tolls on the basis of information available to it in this proceeding. The Board has not included a final approved rate base, cost of service or tolls for the 1994 test year.

Accordingly, Westcoast is required to file for Board approval revised information on rate base and cost of service, together with supporting schedules, reflecting the Board's decisions in Chapters 3 to 8 inclusive. These revisions and the tolls and tariffs are to be filed with the Board forthwith and served on interested parties. Westcoast's filing should include detailed explanations and, where necessary, supporting tables or working papers.

Chapter 10

Disposition

The foregoing chapters, together with Order TG-1-94, constitute our Decision and Reasons for Decision on matters considered in the RH-2-93 proceeding.



R.L. Andrew
Presiding Member



J.-G. Fredette
Member



R. Illing
Member

Calgary, Alberta
March 1994

Appendix I

Order TG-1-94

IN THE MATTER OF the *National Energy Board Act* ("the Act") and the regulations made thereunder; and

IN THE MATTER OF an application by Westcoast Energy Inc. ("Westcoast") dated 14 July 1993, as amended, for approval of interim and final tolls pursuant to subsection 19(2) and Part IV of the Act and filed with the National Energy Board ("the Board") under File No. 4200-W005-7.

BEFORE the Board on 17 March 1994.

WHEREAS, Westcoast, by application dated 14 July 1994, as amended, applied to the Board for an order or orders under subsection 19(2) and Part IV of the Act fixing just and reasonable tolls that Westcoast may charge, effective 1 January 1994, for raw gas transmission, processing and residue gas transportation services that it provides;

AND WHEREAS the Board, in expectation that it would not render a final decision regarding Westcoast's tolls until sometime in the new year, issued Order TGI-5-93 and approved, on an interim basis, the applied-for tolls which Westcoast may charge for the services that it provides effective 1 January 1994;

AND WHEREAS the Board held a public hearing pursuant to Hearing Order RH-2-93, as amended, in Vancouver, British Columbia commencing 18 October 1993 and in Calgary, Alberta;

AND WHEREAS the Board's decisions on Westcoast's application dated 14 July 1993 are set out in the RH-2-93 Reasons for Decision dated March 1994 and in this Order;

IT IS ORDERED THAT:

1. Westcoast shall calculate new tolls in accordance with the decisions set out in the RH-2-93 Reasons for Decision and with this Order and shall forthwith file with the Board for approval and serve on all intervenors to the RH-2-93 proceeding, new tariffs implementing these new tolls;
2. Westcoast shall, for accounting, toll-making and tariff purposes, implement procedures to conform with the Board's decisions outlined in the RH-2-93 Reasons for Decision;

3. Order TGI-5-93, which authorized tolls that Westcoast may charge on an interim basis pending a final decision on the above-mentioned application, is revoked and the tolls that have been authorized thereunder are disallowed as of the end of the day on 31 March 1994;
4. Westcoast shall charge on a final basis, for service commencing 1 January 1994, tolls authorized by paragraph 1 of this Order;
5. The Board's decisions set out in its RH-2-93 Reasons for Decision, and the changes to Westcoast's Tariff authorized in this Order are to take effect on a final basis as of 1 January 1994 unless the Board states otherwise;
6. Westcoast is directed to refund that part of the tolls charged by the Company under Order TGI-5-93 which is in excess of the tolls determined by the Board to be just and reasonable in this Order or, where applicable, to recover the amount by which the tolls contemplated in this Order exceed the tolls charged by the Company under Order TGI-5-93, together with carrying charge on the amount so refunded or recovered at the rate of return on rate base approved in the RH-2-93 Reasons for Decision;
7. The refund or recovery authorized by this Order shall be effected without delay;
8. Westcoast shall file with the Board forthwith, and serve on all interested parties to the RH-2-93 proceeding, new tariffs, including general terms and conditions, and tolls conforming with the decisions set out in the RH-2-93 Reasons for Decision dated March 1994 and with this Order; and
9. Those provisions of Westcoast's tolls and tariffs, or any portion thereof, that are contrary to any provision of the Act, to the Board's RH-2-93 Reasons for Decision dated March 1994 or to any Order of the Board including this Order, are hereby disallowed.

NATIONAL ENERGY BOARD

J.S. Richardson
Secretary

Appendix II

National Energy Board Letter of 23 December 1993 and Order TGI-5-93

File No. 4200-W005-7

23 December 1993

Mr. A.L. Edgeworth
Senior Vice President
Regulatory Affairs and Marketing
Westcoast Energy Inc.
1333 West Georgia Street
Vancouver, British Columbia
V6E 3K9

Dear Mr. Edgeworth:

Re: Westcoast Energy Inc. ("Westcoast")
Hearing Order RH-2-93
Application for Interim and Final 1994 Tolls

The Board has decided to allow Westcoast to charge the applied-for tolls on an interim basis effective 1 January 1994. As well, the Board has made certain determinations concerning Westcoast's deferral accounts for the 1994 test year. Among other things, the Board directs Westcoast to record, without carrying charges, any demand charge credits paid by Westcoast in respect of curtailment of firm service caused by construction of facilities in 1994 in a separate subsidiary account of Account 179, "Other Deferred Debits".

The Board also approves Westcoast's proposed revision to Article 8 of its General Terms and Conditions for Service, which was filed as Exhibit B-31 in the RH-2-93 hearing, effective 1 January 1994.

Pursuant to the Board's decision concerning the receipt point delivery pressure issue, which was rendered during the RH-2-93 hearing, the Board reminds Westcoast to file an amendment to the existing Article 5 of the General Terms and Conditions for Service in accordance with the proposal of the Canadian Association of Petroleum Producers.

Westcoast is directed to serve forthwith a copy of this letter and the attached Order TGI-5-93 on all shippers on the Westcoast system and on interested parties to the RH-2-93 proceeding.

Yours truly,

J.S. Richardson
Secretary

Attach.

Order TGI-5-93

IN THE MATTER OF the *National Energy Board Act* ("the Act") and the Regulations made thereunder; and

IN THE MATTER OF an application by Westcoast Energy Inc. ("Westcoast") dated 14 July 1993 for approval of interim and final tolls commencing 1 January 1994 pursuant to subsection 19(2) and Part IV of the Act, filed with the Board under File No. 4200-W005-7.

BEFORE the Board on 23 December 1993.

WHEREAS Westcoast has filed an application dated 14 July 1993 ("the application") for approval under Part IV of the Act to change its approved tolls effective 1 January 1994;

AND WHEREAS the Board expects that it will not render a decision regarding Westcoast's final tolls for 1994 until sometime in the new year;

IT IS ORDERED, PURSUANT TO SUBSECTION 19(2) AND SECTION 59 OF THE ACT, THAT:

1. Westcoast shall charge tolls based on the 1 January 1994 net tolls listed on Schedule "A", attached to and forming part of this Order, on an interim basis effective 1 January 1994;
2. For accounting and toll-making purposes, the unfunded debt cost rate deferral account is not renewed for 1994. All other cost of service and revenue deferral accounts authorized in Order TG-2-93 are continued on an interim basis.
3. For accounting and toll-making purposes, Westcoast's request to record (a) in its cost of service deferral accounts for 1994 any differences between the forecast balances in such deferral accounts charged or credited to its 1994 cost of service and the actual amounts recorded in such accounts at 31 December 1993 and (b) in its revenue deferral accounts for 1994 any differences between the forecast balances in such deferral accounts charged or credited to its 1994 cost of service and the actual amounts recorded in such accounts at 31 December 1993 is approved on an interim basis;
4. This interim order will remain in effect until the Board's order concerning Westcoast's final tolls for 1994 comes into effect.

NATIONAL ENERGY BOARD

J.S. Richardson
Secretary

Schedule "A" to Order TGI-5-93

Tolls To Be Charged On An Interim Basis

Effective 1 January 1994

(Firm Tolls - Demand Portion)

Service	Net Tolls (\$/10³m³/day)
Raw Gas Transmission	140.18
Treatment @ 10% Acid Gas	255.46
Liquids Recovery (\$/m ³ /d Liquid Products)	693.50
Liquids Stabilization and Fractionation ¹ (\$/m ³ Liquid Products)	8.614
Transportation North	
Shorthaul	4.42
Longhaul	63.60
Transportation South	
Pacific Northern Gas	47.78
BC Gas Inc. - Inland Division	119.68
BC Gas Inc. - Lower Mainland Division	210.89
Export	211.19

1 **Charged on a commodity basis**

Appendix III

List of Issues

This list is intended to assist all parties in defining the issues to be addressed at the hearing. This will not preclude the Board from dealing with other issues which are normally raised by virtue of the Board's mandate pursuant to Part IV of the Act.

At the hearing, the Board will consider, *inter alia*, the following issues:

1. The appropriate rate base, rate of return, throughput and cost of service for the 1994 test year.
2. Whether the current provisions of Article 8 of the General Terms and Condition for Service, "Contract Demand Credits" remain appropriate. If not, what changes are necessary?
3. What are Westcoast's operating practices and policies and have they adequately minimized disruptions to customer service caused by maintenance, repairs, testing, modifications, alterations or expansions of the system? If not, what changes are necessary?
4. What are the current and expected problems that will lead to service disruptions and what alternatives are there for Westcoast to address these problems?
5. Whether demand charge credits are due to shippers on the Westcoast system for interruptions in service during 1993, that result from planned maintenance by Westcoast of its facilities.
6. Whether demand charge credits should be borne by shareholders, recovered as operating costs, capitalized as part of the cost of constructed assets or dealt with by some other means.
7. What is the appropriate disposition of the account balances of the deferral accounts authorized to record the demand charge credits issued to shippers for shortfalls in the delivery of requested gas caused by the 1992 looping project and by 1993 facilities construction?
8. Whether the person year utilization and the salary and wage increases proposed for the 1994 test year are appropriate.
9. What is the appropriate allocation of expenditures among utility operating and maintenance expense, utility capital and non-utility for the 1994 test year?
10. Whether the current method of determining unfunded debt cost remains appropriate.

11. Whether the cost of service and revenue deferral accounts currently authorized, including the "Swing Gas" and the "Liquid Products Stabilization and Fractionation" deferral accounts, should be continued in the 1994 test year.
12. Whether the current method of accounting for foreign currency gains and losses related to long-term debt remains appropriate.
13. Whether the method of billing shippers for the actual volumes of interruptible gas taken each day of the month should be implemented, as directed in the RH-1-89 Reasons for Decision.
14. Whether renomination procedures should be made available and, if so, under what conditions and terms.
15. Whether the increases in delivery pressures at various receipt points located on certain of the Fort St. John raw gas transmission pipelines as proposed by Westcoast are appropriate.

Appendix IV

Westcoast Energy Inc. System Map - Tolling Zones

